

WORKING PAPERS IN ECONOMICS

**Inequality and the Wheel of
Fortune: Systemic Causes
of Economic Deprivation**

by

Flora Gill

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Abstract

This paper synthesises elements drawn from standard economic theory, the concept of 'cognitive dissonance' and ethics. It puts forward a case for maintaining an extensive welfare state. The argument is based on the concept that an individual's fate is based, not on a series of independent random draws, but rather on what is described as 'path-dependent fortune'. In addition, limits on human capacity to identify the merits of individuals independent of social prejudice and preconceptions interact with this path-dependence. The end result is that inequality tends to feed on itself. 'Equality of opportunity' alone cannot remedy this situation. The systematic 'accumulation of disadvantage' on the part of some individuals provides the basis for a moral argument for government intervention, both in the provision of a range of basic needs and in labour market training.

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**INEQUALITY AND THE WHEEL OF FORTUNE:
SYSTEMIC CAUSES OF ECONOMIC DEPRIVATION***

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I. INTRODUCTION

The proponents of state provision of welfare services have been forced to ward off opposition to the concept since the beginning of the century. The poor economic environment which has persisted now for well over a decade has placed the system under further strain; it faces not only progressively dwindling financial resources but also a rising tide of political opposition and philosophical challenge to its very foundations. The opposition to an extensive welfare system argues its case primarily in terms of economic imperatives, typically within an 'economic rationalist' framework, although there is also a more muted opposition based on purely moral grounds.

An emphasis on the importance of equality of opportunities, and even acceptance of the notion of a social duty to achieve such equality, can be found even among ardent opponents of significant public intervention in economic affairs. In contrast, interest in equality of outcomes is much less common. Underlying this reluctance to go beyond equality of 'basic opportunities' often is a belief that once equality of basic opportunities has been secured, inequality of earned income (as distinct from income accruing to ownership of property) will primarily reflect differences in innate ability and free-choice, with any remaining inequalities reflecting the influence of purely random factors. The rationale is that the profit motive guarantees each employee a reward for merit¹; remaining differences in economic welfare are the result of blind luck.²

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The present paper focuses on two specific questions: (i) is the 'economic rationalist' defence of a residual system of welfare logically persuasive; in particular, does it provide a convincing analytical account of the distributive properties of an unfettered market system, and (ii) can an economy which is accompanied by only a minimal system of welfare generate economic outcomes which are consonant with what appear to be widely shared basic concepts of social justice?

II. THE PROFIT MOTIVE, MERIT AND PREJUDICE

The term 'economic rationalism' is used to describe a heterogeneous group, only some of whom are likely to be die-hard economic libertarians. Nevertheless, as a social phenomenon economic rationalism has shifted the agenda of economic policy towards the libertarian non-interventionist end of the spectrum. The inspiration appears to be a particular economic concept of what constitutes a 'free market' system, centring on the analytical notion of 'perfectly competitive market equilibrium'.

This notion has a certain seductive quality: it embraces a rule of conduct which rewards individuals according to merit; it also promises that vigorous pursuit of profit maximisation guarantees to workers rewards according to merit. The first quality appeals to a fairly widespread notion of justice, whilst the second claims to offer a mechanism which both implements and safeguards this notion of justice. Along with this is the promise, consistent with a widely shared belief, that the perfectly competitive system ensures all individuals equal opportunity to display, and successfully convey, their true merit.

¹ The question of whether or not merit is the appropriate criterion to distribute income must to be addressed as a separate issue.

² This is not to suggest that inequality due to blind luck is necessarily more acceptable than inequality due to unequal opportunities.

For the economist, reward according to merit is usually synonymous with reward according to the value of marginal product (or marginal revenue product), an evaluation fundamentally dependent on relative scarcity in the market.³ It is not clear, in fact, that the popular notion of merit fully accords with the economist's concept. Nevertheless, whatever the differences between the two concepts, both seem to share the requirement that reward should be unrelated to an individual's personal attributes such as race, ethnicity, gender and social class affiliation. They share the requirement that people with similar productive attributes should attain similar rewards. The focus of the present discussion is on the ability of the profit motive to establish a reward system which satisfies these shared requirements.

For individuals to successfully convey their merit to employers and management, the latter must be able perceive them through untinted spectacles, free of the distorting influences of social and cultural prejudice. That is, they must make a correct objective assessment of each employee. Further, having made this assessment, employers must defy whatever cultural and social preferences they may have. In other words, the issue is two-fold: (i) the decision makers must be free of cognitive limitations (which would allow prejudice to interfere with observation), and (ii) they must have a compelling interest in choosing strictly on merit, however strong their social or cultural prejudices may be.

A large number of economists, including Milton Friedman, are reluctant to speculate about whether or not people consciously wish to discriminate against particular members of society. Instead, the libertarian view appeals to the profit motive, positing that in perfectly competitive regime the survival imperative will compel profit maximisers to turn a blind eye to whatever desire they might have to engage in discrimination (Friedman 1953). The question arises, therefore, how compelling is the survival imperative?

In a hypothetical regime, with no discrimination at the outset and with a market in perfectly competitive equilibrium (and a world without risk), an employer who seeks to discriminate by rejecting the best employee in favour

³ In the Arrow-Debreu General Equilibrium model reward for labour would depend on technology and consumer preferences, meaning that merit is rewarded according to its market valuation, with relative scarcity at the core. This eschews the notion of (physical) marginal product, but it also sidesteps any problematic aspects of individual perceptions of, or social preconceptions about, merit.

of another with more appealing social characteristics will destroy the viability of the enterprise. This occurs because in perfect competitive equilibrium each firm, by definition, is making the minimum profit which provides a return to equity no higher than the bank rate of interest.⁴ Indeed, in such a putative state of affairs, the sheer desire for survival will successfully militate against a deviant discriminating individual; discrimination could be introduced only in a well-coordinated fashion (or by orchestration from above, as in the Third Reich).

Thus far the logic of the argument is impeccable. In perfectly competitive market equilibrium, discrimination can be either uniformly applied or altogether absent. What does not follow, however, is the proposition that the profit motive is sufficient to bring about the demise of discrimination in an economy where it already exists on a substantial scale.

Suppose that discrimination is universally practiced, so that its consequences, whatever they may be, are built into the cost structure. Now imagine the emergence of a (culturally) 'deviant' employer who follows eccentric non-discriminatory employment practices which bear him handsome profit. Would this deviant behaviour necessarily become standard practice? Survival is not at stake. Instances of non discriminatory practice may exist, but there is no systemic force compelling others to follow unless the deviant practice is emulated by a sufficient number of agents that they exert serious competitive pressure on discriminators. In other words, the new employment norm must diffuse throughout the employing community before it can have a seriously compelling impact. The circumstances which could bring about such a critical watershed will depend on both the economic and cultural environment.

A little digression, relating to an observation made some time ago by Thomas Schelling (1972), may prove a helpful. Schelling was examining the proposition that an influx of blacks into an hitherto lily-white suburb will set in motion an exodus of white residents, in time transforming it into a raven-black suburb. His analytical conclusion was that the chance of such a conversion occurring is exceedingly small, unless everybody leaves immediately on the entrance of the first black resident (a behaviour not

⁴ Note that this is the case with constant returns to scale. With diminishing returns to scale, positive residual profit is of course permitted because it is the marginal, not the average, return which equals the rate of interest.

observed in practice). Schelling's analysis concluded that there exist an infinitely large number of feasible equilibria (of racial mix), each of these associated with a particular distribution of the threshold value that the proportion of blacks must reach before an individual decides to move out of the suburb. Thus the ultimate racial mix of the neighbourhood actually depends on the degree of diversity of attitudes towards blacks, and/or the degree of pessimism about the ultimate impact of the changing racial mix on the value of real estate. This analysis, I propose, carries through to the dynamics of change in employment practices and their ultimate impact on prevailing standards: unless one postulates from the start that people act strictly in unison (either everybody discriminates or nobody does) we cannot conclude with any certainty that 'deviant' behaviour ultimately becomes the norm.

This is an issue which hinges on the process of interaction between social culture and the economy. Since economics tends to ignore such interactions, the concept of the perfectly competitive equilibrium does not offer a fruitful frame of analysis in this case.⁵

The argument above has left intact an implicit assumption in the libertarian's analysis which postulates that discrimination manifests itself only through conscious free-choice. In other words, the underlying premise is that decision makers always assess people accurately in a manner untainted by a perception bias. Cultural prejudice enters the picture only in a second phase where the rewards for profit maximisation are carefully weighed against the 'pleasure' derived from discriminating. Obviously, this assumes away the more fundamental, subtle and highly insidious manner by which social prejudice permeates our culture, and the very manner in which we perceive reality. It ignores, in other words, the limits of human cognitive capacity and the discretionary power these limits bestow on the prevailing social culture, an issue which is taken up in the next section.

⁵ If we shift ground from the notion of the single-minded profit motive as a survival imperative to a definition of it as an individual cultural and psychological phenomenon which is shared by the vast majority of society (a definition, as I mentioned above, that most economists are reluctant to adopt), we may logically deduce that profit maximisation can seriously undermine discrimination. This is a tautological statement. It simply says that where cultural prejudice has given way to the profit motive, the profit motive dominates. This does not establish the ability of profit maximisation to reduce or eliminate prejudice.

In conclusion, economics is correct in pointing out the potential for tension, indeed conflict, between the profit motive and social prejudice. The resolution of this conflict, however, is a complex issue which depends on a whole set of social and economic circumstances, and it is not necessarily resolved in favour of the profit motive and against social prejudice.⁶

III. COGNITIVE LIMITS, PREJUDICE AND HIERARCHICAL EMPLOYMENT STRUCTURES

The limits to human cognitive capacity, and the inability to form social knowledge significantly free of social and cultural prejudice, must form an integral part of any systematic intellectual attempt to explain the distributive outcomes of the modern socio-economy. This is particularly important in a system which attempts to reward merit. In addition, the unquestioning acceptance of extensive and well-established hierarchical structures in the workplace seriously restricts the scope for rewarding according to merit. Finally, the combined effects of cognitive limitations, social and cultural prejudice and the pervasive presence of hierarchical structures severely limit the influence of purely random variations on the distribution of earned income, even when we focus purely on labour income.

(i) Prejudice, Cognitive Capacity and Reward for Merit

A system of remuneration which rewards individuals strictly according to merit is predicated on the ability to accurately assess merit, the only tolerable error being the truly random one. Since merit is often not directly observable, it is typically gauged indirectly, relying on a range of indicators believed to be correlated with productive capacity, suitability for the job, and the like.

⁶ Needless to say, there are circumstances in which it is profitable to discriminate as for instance when customers or other employees have prejudices (the latter being at the core of the case analysed by Arrow (1974)).

Social characteristics of employees play a significant role as indicators of their promise. It is, indeed, well known and extensively documented that race, gender, class and a host of other social characteristics of an individual play a significant role in determining their perceived merit.⁷ Propositions which play down the influence of these factors assume not only a significant degree of open-mindedness on the part of decision makers, but also that they have an efficient learning capacity. That is, they assume that individuals and societies are not only keen to identify true merit, but also that they are capable of generating the requisite information and possess the intellectual capacity to properly employ it. This assumes away the possibility that deep-seated cultural prejudice is strongly sheltered by limited cognitive capacity. It also ignores the fact that when the workforce is highly segregated the opportunities for learning, that is for generating requisite information, are meagre.⁸

The implications of imperfect information have been a major topic in the economic literature for some time now. In labour market research, this has spawned a particular model of discrimination known as 'statistical discrimination theory'. This recognises that information barriers make it impossible for an employer to gauge precisely an individual's productive capacity. Instead, the theory suggests, the employer forms a *conditional* expectation of this capacity, given an array of observable attributes of the individual, including social characteristics. Clearly, when such expectations are deemed unbiased estimates of the true mean of the group with which the individual is affiliated, the deleterious effects of discrimination are confined to cross-subsidisation within the group with above average productivity individuals subsidising those below the average, and with the total income accruing to the group as a whole being seen as identical to its value in the

⁷ Claudia Goldin's (1990) seminal study of labour market discrimination along the gender divide (in the United States since early 19th century) has made its mark on current economic thought, at least in the United States. An earlier comprehensive survey of the economic analysis of labour market discrimination is offered by Marshall (1974). Other examples are Jennett & Stewart (1987) and Gill (1993).

⁸ Spence's (1974) path breaking work on 'market signalling' provides a comprehensive analytical argument about the robust nature of racial prejudice despite the presence of a strong profit motive and market competitiveness. The core of the argument is that information deficiencies can entrench discrimination.

putative discrimination-free regime.⁹ This is no longer the case when conditional expectations are biased. I propose that the presence of cognitive limits means that the likelihood of forming biased estimates is substantial, and that the scope for effective learning through experience is limited.

Leading economists have paid increasing attention to the implications of *cognitive dissonance* for a range of economic issues. Among these, Akerlof and Dickens (1982: 309) observe that '... persons who have made decisions tend to discard information that would suggest such decisions are in error because the cognition that the decision might be in error is in conflict with the cognition that ego is a smart person'. In discussing the need to incorporate the consideration of cognitive dissonance into economic analysis, they also observe that: 'The cognitive dissonance model not only predicts systematic differences in *interpretation* of given information but also systematic differences in *receptivity* to new information according to preferences [emphasis added].' (Akerlof & Dickens 1982: 309). These observations are not incongruent with the basic idea of statistical discrimination. However, they do suggest that the distributional impact of discrimination is not confined to internal (within group) cross-subsidisation: biased estimates are possible, and discrimination between groups can be a real possibility.

Having emphasised the cognitive limits to the ability to recognise merit, it must also be pointed out that questions of perception aside, the very definition of merit varies with the social and cultural context. Different cultures, following different codes of ethics and different social norms of behaviour, can generate significantly different concepts of merit. For instance, some may place a particularly high value on cooperative conduct, adopting a blanket rule that cooperative individuals are more meritorious. In contrast, more individualistic cultures will tend to offer a premium to 'go getters', yet each society will genuinely believe that the socially favoured attribute is more conducive to good economic performance. In other words, each will be partially blind to the positive contribution that individuals with behavioural characteristics other than those favoured are capable of making. Cultural differences often involve not only inter-country differences, but also inter-class, -gender and -ethnic differences within a given country.

⁹ The cross-subsidisation case is clearly made in Spence (1974).

In conclusion, what makes the prospects of systematic award according to merit irrespective of the social characteristics of an individual particularly bleak is the inevitable interaction between socio-cultural prejudice and cognitive limits, particularly in a highly segregated environment. The potential for merit as a path to equality is seriously limited because both the perception and the definition of merit are not independent of social inequality. That is, in a society where social and cultural prejudice prevails, social affiliation becomes a dimension of merit itself.¹⁰

These observations are valid even for an analysis which remains well within neo-classical marginal productivity theory. True, this approach emphasises that individuals' rewards for innate and acquired skill, as well as features such as personal integrity, depend on the manner in which these personal attributes interact with capital equipment, and on their relative scarcity, a certainly valid observation. But it is also true that the model usually assumes away any cognitive limits on the ability of management to accurately assess individual 'marginal products'; and it also assumes away the manner in which value systems, social affiliation and cultural preconception enter hiring and task assignment decisions at the firm.

(ii) The Hierarchical Mode of Organisation and Reward According to Merit

The modern socio-economy forms a complex web of tasks defined not only along a horizontal plateau of differentiated economic activities carried out by different individuals, but also along a vertical axis which defines their rank order in terms of socio-economic status. Some maintain that hierarchical structures at the workplace, and the accompanying pay structures, reflect the structure of the workforce in terms of the workers' intrinsic merit. Let us set social prejudice aside for the moment; is it truly possible to attain an earning

¹⁰ The principle of reward for merit is sometimes invoked as a moral imperative, because it affirms the rights of individuals not be disabled by dint of group affiliation. That is, it is often believed to be an effective bulwark against labour market discrimination. Nevertheless, it is a morally problematic concept. Not only does it deny the consideration of needs, but it really promises to remove only one source of inequality - the inequality of access according to group affiliation. More fundamentally, merit itself is not a measure of the absolute good but rather a measure of a quality which is an amalgam of prevailing social values, and market scarcity. This does not necessarily impart on it compelling moral content.

structure which genuinely reflects the structure of merit in the population in an environment in which a well-defined and fairly rigid hierarchical structure is unquestionably accepted? Suppose the access to each of the slots in the hierarchical complex were to be determined strictly according to merit, does it necessarily follow that there will be a close match between merit and reward (in terms of the combined value of pay and social prestige)?

To be a genuine reflection of merit, the hierarchical structure should be shaped by the structure of merit. Very unequal work performance should result in a very unequal and elaborate hierarchical and pay structure, whereas where people are more equal in terms of merit, the hierarchical structure should adjust itself accordingly.¹¹ In reality, however, both hierarchical organisational structures and the accompanying pay levels remain rather rigid. They are accepted as independent entities, assuming their particular form independent of the comparative pattern of merit of individuals.¹²

(iii) Misfortune begets Misfortune; the Consequences of Path-Dependent Fortune

This paper focuses on the factors which determine the economic fortunes of those who depend on the income they earn as workers. The provision of equality of basic opportunities is presumably designed to minimise the influence of inequality in the ownership of wealth on the distribution of wage and salary income. The central argument of the paper is that even if these influences are successfully blocked as far as the provision of educational

¹¹ Pay levels should be similar, and to the extent that some hierarchy is organisationally needed, the option of manning it by rotation of personnel should be seriously considered.

¹² Access to jobs within relatively rigid structures must be rationed. In principle, therefore, it is always possible that only a subset of people equal in terms of merit will occupy identical occupational positions. This, in turn, suggests that even if the queue to better paid and more prestigious jobs is formed strictly in terms of merit, the structure of pay and social prestige conferred by the job hierarchy does not necessarily reflect the structure of the population in terms of merit. Similarly, Thurow's (1974) job-competition model builds on the proposition that the hierarchy of jobs structures is a well defined independent entity, with individuals being ordered in a 'queue' according to rules defining access.

opportunities during the formative years is concerned, there will remain class, gender, race and other social factors which will systematically influence the individuals' fortunes in the labour market, and significantly so.

Pure luck as such plays a much more limited role, not only because of these systematic influences but also because in the labour market job progression is structured. The labour market has a well established highly elaborate structure of job hierarchy which defines not only a system of 'prizes' to be allocated in accordance with estimated merit, but also a system of stepping stones which crucially determine the height to be scaled in the remainder of the journey up the ladder. This is so because jobs are not merely prizes for an already demonstrated merit, but also entry tickets which ration access to training opportunities and improved opportunities to demonstrate ability. Hence, although a random influence on the size of the prizes allocated to a group of people intrinsically equal in merit does exist it is confined to the first round of prize allocation. Since prizes are also stepping stones determining scope for advancement in the next round, what is initially a matter of pure luck takes on a new meaning. What initially is the result of a purely random event is subsequently treated as an indicator of the individual's true innate ability. Success brings further success, and misfortune begets misfortune.¹³ Thus, for instance, unemployed people, even when they are purely the victims of bad luck, run the risk of being perceived as inferior workers. In other words, they are often treated as if unemployment had carefully separated the wheat from the chaff.¹⁴ Here again, cognitive dissonance plays a crucial role in forming a 'path-dependent' set of opportunities.¹⁵

¹³ Thanks are due to Bettina Cass for drawing my attention to the fact that Walzer (1983) makes a similar observation when he discusses the 'accumulation of advantage and disadvantage' which accompanies the use of the principle of *merit* in the labour market.

¹⁴ Ironically (and sadly) individuals themselves experience acute loss of self-esteem, becoming victims of the cognitive trap that treats them as deficient in innate merit, even when they are victims of pure chance forces.

¹⁵ For the notion of path-dependence in the conduct of economic structures see David (1988).

(iv) Bearing the Brunt of Economic Change

Structural change, the commitment to place inflation ahead of unemployment and the exposure of domestic production to more vigorous foreign competition all have well defined and highly predictable (rather than random) distributive consequences.

Placing price stability ahead of employment stability, as we have done for more than a decade now, has generated a disproportionate burden on a well-defined subset of the population. An x per cent level of national unemployment does not present every individual with an equal chance of losing their job. Neither have we seriously pursued avenues such as a job-sharing and reduced hours of work to distribute the impact of a downturn more equally. Instead, an increase in the national level of unemployment has meant an almost equal increase in job losses.

Similarly, the distributive impact of structural change, whether autonomous or induced from above by state policy, is inherently very uneven. Microeconomic reform and tariff reduction have typically been justified in terms of the economic benefits which would flow from them to the community at large, yet the brunt of change falls on specific economic sectors, geographical areas and occupational and demographic groups. Prime among the losers are middle-aged blue collar workers in the manufacturing industries who possess few transferable skills. For them structural change involves loss of accumulated seniority benefits and firm-specific skills, and little opportunity to acquire new skills. The inevitable result is often a failure to sustain the level of earnings and occupational responsibility hitherto enjoyed, or a prolonged period of unemployment.¹⁶ This is a highly predictable result. Employers, rightly or wrongly, find young new entrants to the workforce more malleable, and certainly on average, more able-bodied. Thus, older workers, once unemployed, are placed at the end of the hiring queue. It is not surprising, therefore, that although the young are most

¹⁶ Available empirical studies show that those who are fortunate enough to find new employment often experience a permanent decline in economic well being (Curtain 1985, 1987). See also Gill 1989 pp. 462-465.

prominent among the unemployed in general, older people are more numerous among the long term unemployed. This is a pattern one should reasonably expect to find in an unfettered market exchange system.

While managers placed at the higher echelons of the pay hierarchy are typically rewarded with incomes which are sufficiently high to permit the accumulation of substantial financial assets, workers at the bottom levels of the socio-economic hierarchy never have adequate discretionary income to permit accumulation of sufficient capital to provide full (or even partial) existence on interest and dividend income. It is incorrect, therefore, to suggest that the recent increase in unemployment among managers places this class on a par with the mass of much lower-paid production workers.

In summary, if the same lottery was repeated numerous times in each person's life, then one might reasonably hope that results would average out and that lifetime income, welfare etc. would be reasonably non-stochastic. However, the presence of path-dependence means that one's lifetime circumstances are significantly subject to chance, and that bad breaks are difficult to recover from.

Will cash transfers provide an effective remedy? I think not, for a number of reasons. In particular, work is a multi-dimensional entity. Not only does it provide the individual with purchasing power, but it also affects self-esteem, the sense of social affiliation, and individual fulfilment in general. Consequently, failure to secure fair access to jobs cannot be simply compensated by cash transfers. When soaring national levels of unemployment bar people from access to jobs simply because of their age (recent reports show that the danger zone is entered at the age of 40), individuals are apt to feel that they have been cast off from society; cash transfers, though essential for sheer survival, add insult to injury. Workers who have been displaced by technological change, or because they were employed in a declining sector, share the same experience. They often find themselves at the bottom of the occupational ladder simply because they have neither the financial means nor the emotional strength to embark on a major training program which would enable dignified occupational mobility.

Furthermore, experience has shown that suitable training facilities, are seldom available within the private sector. To date retraining facilities for adult population are found on any significant scale only in Germany and the Scandinavian countries, where they are provided by the public sector as an ongoing commitment.

IV. SOME DISTRIBUTIVE ASPECTS OF UNEQUAL PURCHASING POWER AND SOME POLICY IMPLICATIONS

Thus far the discussion has focused on the rationing of access to employment. I would now like to turn to the product and services market, where market bidding provides a rationing mechanism which potentially allows those with disproportionate purchasing power to secure preferential access to goods or services, even to the point of denying access to less well endowed individuals. The very essence of having a disproportionately large income is that it offers advantageous access to goods, both in terms of quantity and quality. However, equality of opportunity may be undermined if market bidding denies less well endowed individuals adequate access to goods that are vital for them to have genuine equality of opportunity. This raises two interrelated but distinct questions: first, can the paradoxical situation arise where access to such goods deteriorates amidst economic growth; and secondly, is it realistic to attempt to redress this by implementing of earmarked cash transfers to low income households (eg rent subsidies), within a system based on private sector provision of products and services.

In political and economic debates on the welfare state, housing, health and education services have often been described as 'merit' goods, this term being intended to convey that they should be available, at least in part, independent of the individual's ability to pay for them.¹⁷ Indeed, most readers will probably agree that equality of opportunity requires adequate shelter, geographical access to jobs, satisfactory access to health care and access to quality education, although the precise definition of 'adequate' will remain contentious.

¹⁷ This use of the term 'merit' is distinct from that used in earlier sections of this paper. The term is used with these two different meanings in keeping with convention.

Will access to such services improve steadily with the passage of time? Is it necessarily the case that, with steadily growing real income per capita, low personal income will cease to jeopardise access to these goods? Or is there a significant risk that the opposite may actually occur; that growth itself may distribute certain services away from the low-paid (at least in a private provision regime)? With a stable structure of relative prices and with non-declining real incomes at the lower end of the income scale, access to these goods for those on low incomes will remain unabated. However, a different scenario may unfold amidst growth, if the supply of some merit goods is relatively inelastic, even with a stable distribution of nominal incomes, simply because of the impact of relative price changes. Real growth in average income per capita may involve a decline in real incomes at the lower end of the pay scale (despite an unaltered distribution of nominal income), when the weight of goods experiencing a sharp rise in relative prices in the personal consumption basket is negatively correlated with personal income. If merit goods are significantly affected by such price changes, the consequence could be either a substantial contraction of consumption of merit goods on the part of the low-paid, or decline in real income left for spending on non basic-needs goods. This could mean either inadequate use of goods and services vital to genuine equality of opportunity or a very thin margin of existence above subsistence level.¹⁸

Even in the absence of significant growth, changes in taste for these merit goods among high income earners can have similar effects. An example is the trend to 'gentrification' of the inner areas of major Western cities in the last two decades, leading to a dearth of low cost accommodation and the gradual dislocation of low income residents.¹⁹ If job markets (and community amenities) moved *pari passu* to areas with cheaper accommodation, this issue would not be worthy of mention. This is not the case, however. The availability of housing for the very low-paid remains a serious problem,²⁰

¹⁸ Such scenarios do not readily spring to mind when the analytical image of reality is inspired by models which tend to perceive inelastic supply as primarily a Marshallian short run phenomenon, but they are suggested by real world observations.

¹⁹ True, in the early post-World War II era the large scale move to suburbia by the more affluent offered newly arrived migrants favourable opportunities to combine job and residence location.

²⁰ See Yates (1989) and Yates & Vipond (1991) for an extensive discussion of inequality of access to housing in Australia.

and this is exacerbated by the relative rigidity of the geographical distribution of jobs.

In principle, rent subsidies should reduce the risk of forced geographical dislocation and ease geographical mobility when it is dictated by employment imperatives. In view of the fairly widespread agreement among economists that considerations of technical efficiency do not favour public over private provision of health care and education, there has been significant support for the provision of rent subsidies to low income households (Barr 1987: 377).²¹ If the existence of such subsidies can elicit a substantial expansion in the stock of private rental accommodation where it is most needed, then access may indeed improve significantly at relatively low fiscal cost. If, on the other hand, the rental accommodation stock fails to expand significantly, subsidies may need to be very large to allow the low-paid to compete with those who have more abundant means. The magnitude of such subsidies could well be politically prohibitive.

How likely is it that the stock of rental accommodation in the private sector will expand in response to rent subsidies? To be effective, such subsidies would need to offer prospective investors a significantly improved *expected* return on capital. Is it realistic to expect this, particularly when the risk associated with returns dependent on government subsidisation is taken into account. That is, the *risk-adjusted* return which remains after adjusting for the risk due to political uncertainty (where radical changes from one fiscal budget to another are not unknown) must be large enough to dominate alternative investment opportunities. A major problem for private sector investors is that even the existence of such income transfers may depend on the vagaries of political change.²² Overall, the case for rent subsidisation appears to weaken considerably when we take these considerations into account.²³

²¹ Note, however, that Barr emphasises that 'This is not an argument against public provision' (Barr 1987: 377).

²² See Whitehead (1989) for an analysis of the prospects of the rent subsidy scheme and the program of privatisation of accommodation for the low-paid under the Thatcher government in the United Kingdom.

²³ In comparing private vs. public provision in terms of technical efficiency, it is worth recalling that Arrow and Lind pointed out that the consideration of *risk-spreading* may

Historically, the involvement of the private sector in the provision of health care and education has been more limited. At issue, therefore, are the possible distributional consequences of a tilt in favour of substantial private provision.²⁴ Barring historical accidents, the prominent role played by public provision in these two areas may reflect comparative advantage, either in terms of technical efficiency or of efficiency in achieving specific distributional goals, or both. The comparative attributes of public and private provision of health and education services have been extensively discussed in the economic literature, and there seems to be substantial agreement that public provision can be justified in terms of technical efficiency (Barr 1987: 357).²⁵ In addition, however, public provision may be more effective in achieving particular distributional goals, such as rationing access to health care according to need, rather than according to individuals' purchasing power.

As long as public provision has the wide support of the community, with a constituency which represents a wide cross-section of income levels, rationing of access according to need is not under threat, regardless of changes in the level and distribution of income. Such support, however, is delicately balanced when the standard of public sector provision fails to keep pace with living standard in the community at large, or when it fails to provide a standard of quality acceptable to those on high incomes. A combination of widening income gaps and diminished public expenditure on health services, therefore, generates the real possibility of a progressive shift of middle and high income people away from public hospitals towards exclusive medical institutions providing a range of luxury services, and, most importantly, no

render public investment superior (in terms of Pareto-efficiency) even when it ranks below private investment in terms of risk free discount rate (Arrow and Lind 1970).

²⁴ The present discussion focuses on economic consequences of such a tilt. A concern also been expressed about political consequences of a tilt in favour of private provision of education and health care (Klein 1984).

²⁵ Note that central to this proposition are '... information problems which are ignored in much of the pro-market literature' (Barr 1987: 357). For the theoretical aspects of the efficiency issue, as well as a discussion of distributive justice concerns see the older, yet still pertinent, discussion offered by Arrow (1965 and 1973).

waiting time.²⁶ In contrast, those dependent on public hospitals may experience long delays.²⁷ More importantly, the quality of medical services is at stake if the level of resources available to public hospitals is allowed to fall, because a starved public hospital system is ultimately prone to experience loss of its medical staff. Similarly, with a sufficiently meagre allocation of real resources to the public school system, education services run the same risk of a progressive diversion of resources away from low income earners as middle and upper class people lose interest in public education and high quality teaching staff is lured away by more attractive jobs outside the public education system. The process which could generate such a systematic pattern of redistribution of resources is analytically known as the *adverse selection* phenomenon, where deterioration of pay and work conditions drives away the better workforce. These propositions are based primarily on theoretical analysis, but they serve to highlight scenarios which are well within the realms of possibility.

V. MORAL IMPERATIVES

The fundamental subject of this paper is the distribution of scarce resources, be they jobs and pay levels or access to basic services such as housing, education and health. In theory, 'equality of opportunity' would suggest that the distribution of jobs, health and educational resources should bear no systematic relationship to either the wealth or social affiliation of the individual. In practice, as this paper argues, we have a number of mechanisms for ranking individuals and groups which are related to their socio-economic characteristics. The presence of such systematic relationships

²⁶ Note that what is at stake is not simply the difference between private and public hospital rooms (which cannot be frowned upon in terms of the merit goods argument) but rather the very quality of the specialist medical care.

²⁷ On barriers to access to health care services see Macklin (1990). For an analysis of the equity issues which are involved in the rationing of health care resources see McClelland (1991).

establishes a case for the non-residual welfare state as a matter of basic social moral duty.²⁸

This should not be interpreted as suggesting that a non-residual welfare state would or could remove all breaches of social justice inherent in the current socio-economic structure. Neither should the welfare state limit its intervention in the allocation of resources to situations where there exist systematic relationships between wealth and social affiliation on the one hand and access to jobs, decent housing, health and educational resources on the other.²⁹ The focal point of this paper, rather, is on the presence of such systematic relationships and on the consequences which flow from this observation for social policy.

So far in this paper it has been treated as self-evident that it is a violation of fundamental principle of justice if wealth, race and gender systematically influence access to job, health and educational services. In fact, there exists literature on this subject, spawned in part by the rebuttal to the neo-libertarian critique of the welfare state. As Plant (1985) points out, for the neo-libertarian such systematic patterns of distributive outcomes have no ethical implications for social policy, certainly not as a matter of citizens rights. This is so because the neo-libertarian identifies a breach of citizens rights only where freedom is diminished as a result of an action guided by an intention to restrict the freedom of other individuals; and since the distributive outcomes of the market system are brought about by the net effect of acts of free exchange between individuals, this philosophical position argues, no intention to restrict the access of others can be imputed to any of the participating individuals. Hayek (1967, 1976) arguably the most eloquent protagonist of the neo-libertarian position, does not deny that the 'free market' generates a great deal of suffering for some people, but in the absence of a deliberate intent to cause misfortune, he insists, welfare can be treated

²⁸ Although the bulk of economic analysis diligently shuns ethical issues a significant number of prominent economists have maintained interest in the subject of ethics and economics. The elimination of ethics from economic analysis, Sen argues, limits the scope not only of welfare economics, but also of 'predictive economics'. That is, it impairs the ability of the economists to properly predict the economic conduct of individuals: "The jettisoning of all motivations and valuations other than the extremely narrow one of self-interest is hard to justify on grounds of predictive usefulness, and it also seems to have rather dubious empirical support." (Sen 1987: 79). David Collard (1978) made a similar observation in his *Altruism and Economy: a Study in Non-selfish Economics*.

²⁹ The concept of social justice is examined on a broader canvas by Cass (1991).

only as a gift, not as social right. Plant offers an eloquent and incisive critique of this philosophical view point. He argues that intent (to restrict freedom) alone offers a very inadequate moral foundation for a theory of social justice. The notion of breach of justice, Plant argues, must be expanded to encompass cases where socio-economic misfortune is foreseeable and its pattern predictable, regardless of the purpose guiding the actions of agents who individually or collectively give rise to the undesirable outcome. Social systems known to be generating undesirable distributive outcomes in a predictable and well-defined pattern can therefore be deemed to be breaching basic tenets of social justice.

Arrow (1984) offers an interesting critique of Nozick's (1974) entitlement theory of justice whose core, Arrow points out, is an '...attack on all patterned views of distributive justice...' (Arrow 1984:175). This critique also puts forward an argument in support of the welfare state as an agent of social justice. Whereas Nozick maintains that society must refrain from redistributing initial property (existing prior to any act of exchange), Arrow emphasises that any such property in fact owes its (market) value to the very existence of society. Had the same assets been owned in a Crusonian isolated existence, they would have had little, if any, value. That is, it is the very existence of society which makes scarce resources valuable. Hence, Arrow says, "...there exists a surplus created by the existence of society as such which is available for redistribution" (Arrow 1984:187).

This proposition hits at the core of Nozick's defence of property rights, because, Arrow argues, Nozick seems to suggest that society must restrict itself to redistribution of 'gains from trade', refraining from redistribution of the initial property entitlements (Arrow 1984:181, 187). If indeed, Nozick accepts redistribution of gains from trade then Arrow's argument turns Nozick's position on its head, exposing a flaw in the internal logic of the defence of absolute property rights. Fundamentally, Arrow emphasises that individuals owe much of what they possess by way of economic welfare to the very existence of social organisation; this in turn limits their right to reject the principle of distributive justice in terms of absolute rights over property.

In summary, Arrow and Plant both expose crucial areas of weakness in the neo-libertarian argument, suggesting, in effect, that the libertarian ethical tenets themselves may, after all, support a much more comprehensive

provision of welfare than admitted by the professed position. In the same vein, it could also be suggested that the economic rationalist idealisation of the perfectly competitive market and its distributive outcomes (when supplemented with only a residual welfare system) reveal an unadmitted quest to achieve certain patterns of distributive justice - a pattern which eliminates any systematic influence of socio-economic affiliation on the distribution of wage and salary income.³⁰

VI. CONCLUSION

Income inequality is a persistent and pervasive phenomenon, and it seems clear that we have neither the political will nor the organisational capacity to bring about a full-fledged egalitarian society. Nevertheless, we do share some concerns about the extent of inequality and the forms that it takes. Whilst concern about inequality of outcomes is certainly not shared by everybody, concern for equality of opportunity is more widely held. Underlying this is the belief that individuals should not be handicapped by their class, race or gender affiliation. Setting aside wealth, this suggests that the distribution of individual's labour incomes should have a systematic relationship only with the innate abilities of individuals and their occupational preferences, with any remaining differences reflecting pure chance.

The paper argues that in reality other systematic effects come into play, and that the influence of pure chance is seriously limited. The combined effect of social prejudice and the inherent limitations of human cognitive capacity can entrench labour market discrimination, even when the intent to discriminate is altogether absent. Where income inequality is substantial, inequality in consumption, particularly due to the supply characteristics of housing, health

³⁰ This paper has not made any explicit reference to needs as an allocation criterion. However social justice criteria which are altogether blind to needs are exceedingly narrow. Public provision of services has an advantage over private provision in terms of its capacity to ration according to need. Here again, to be effective subsidisation of private acquisition will often need to be fairly generous.

and education services, can lead to a situation where acute economic deprivation is experienced by a significant proportion of those in full-time employment. In addition, structural change, macroeconomic stabilisation and microeconomic reform policies all generate well-defined patterns of job and earnings loss, with specific socio-economic groups bearing the brunt of change.

The presence of such systematic distributive patterns justifies substantial public initiative. The concept of welfare provision, the present paper argues, must be extended beyond the minimalist domain. This is implied not only by the moral position of those who seek more equal distributive outcomes but also by the implicit moral wishes of those who believe that a welfare system which confines itself to the provision of equality of basic opportunities guarantees that no systematic forces other than innate ability and free-choice influence the distribution of labour income.

Furthermore, public initiatives must not be limited to cash-transfers, because they offer only limited scope for redress of inequality. In particular, the paper emphasises, rent subsidies, are too dependent on the vagaries of politics to offer a solid foundation for achieving a sustainable increase in the purchasing power of the poor. The risk adjusted rate of return on private capital invested in rental accommodation for people in need of income support will, therefore, tend to be too low to elicit substantial supply response.

What is needed is a welfare policy with substantial involvement in both the product and labour markets, including the provision in kind of a range of services such as low income housing, health care, education and retraining³¹, and legal initiatives such as affirmative action. If we are to move towards achieving a fair balance of social justice, we may need to accept that certain socio-economic conditions entail substantial public involvement in the provision of merit goods and the elimination of discriminatory conduct.

³¹ Training and retraining are not panaceas for large scale national unemployment. Neither can poverty and the non-pecuniary aspects of job-loss be eliminated by employment benefits. What this paper sets out to emphasise is the moral obligation owed by those enjoying stable prices and growing incomes to those who bear the brunt of economic restructuring and the focus of policy on the balance of payments and inflation.

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