ARTHUR M. OKUN

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Foreword

CONTEMPORARY American society is, in a sense, a split-level structure. Its political and social institutions provide universally distributed rights and privileges that proclaim the equality of all citizens. But its economic institutions rely on market-determined incomes that generate substantial disparities among citizens in living standards and material welfare. The differentials in income are meant to serve as incentives—rewards and penalties—to promote efficiency in the use of resources and to generate a great, and growing, national output.

The resulting mixture of equal rights and unequal incomes creates tensions between the political principles of democracy and the economic principles of capitalism. Money is used by some big winners of market rewards in an effort to acquire extra helpings of those rights that are supposed to be equally distributed. For some of them, it obtains head starts that make opportunities unequal. For some who incur penalties in the marketplace, the result is a degree of deprivation that conflicts with the democratic values of human dignity and mutual respect. Yet some economic policies designed to reduce the scope and magnitude of inequality weaken incentives to produce and otherwise impair economic efficiency. At many points along the way, society confronts choices that offer somewhat more equality at the expense of efficiency or somewhat more efficiency at the expense of equality. In the idiom of the economist, a tradeoff emerges between equality and efficiency.

That tradeoff is the subject of this essay by Arthur M. Okun. For the greater part of his professional career the author has focused his intellectual energies on a quite different tradeoff. As a graduate student at Columbia University, as a faculty member at Yale University, as a member and then chairman of the Council of Economic Advisers, and, since 1969, as a senior fellow at the Brookings Institution, Okun has concerned himself mainly with the unsolved problems embedded in the tradeoff between unemployment and inflation. Here he has briefly taken leave from his main preoccupation in order to turn his attention to what he considers an even more importunate and pervasive tradeoff, with even bigger stakes.

The tone and character of the book (as well as its subject matter) distinguish it from Okun's other professional writings and, indeed, from most Brookings publications. It is a personal work, recording the author's values, judgments, and experience. As such, it focuses on our national institutions and problems, with which he is most familiar, rather than on global or local issues. It is intended to be comprehensible to readers interested in social issues who do not have a background in economics. Okun transmits some messages to his fellow professional economists in the footnotes, which represent a set of brief additional comments and a selective citation of writings that interest him particularly.

The author feels strongly that "the market needs a place and the market needs to be kept in its place." This recurrent dual theme of the book distinguishes Okun both from radical thinkers, who would abolish market capitalism, and from exponents of laissez-faire, who would generally broaden its role. Okun values the market as a decentralized and efficient system for spurring and channeling productive effort and for promoting experiment and innovation; he also sees it as a protector of individual freedom of expression. But he insists that other values must be protected from the potential tyranny of the dollar yardstick and that many rights and powers should not be bought for money.

The importance of these other values and the problems of protecting them from transgression by the market are the subjects of chapter 1. In chapter 2, Okun reviews various arguments in favor of market capitalism. He explains why he rejects reward for contribution as an ethical principle, but accepts it, within limits, as a pragmatic necessity. He compares the degree of efficiency, equality, and freedom provided by current mixed capitalism with that obtainable from full-fledged socialism, indicating his strong skepticism about the merits of socialist proposals.

In chapter 3, the nature and scope of economic inequality are examined in some detail, as is its relation to inequality of opportunity. Okun argues that both efficiency and economic equality can be increased by attacking some inequalities of opportunity, such as racial and sexual discrimination in jobs and barriers to access to capital. In the final chapter, Okun evaluates the potential of progressive taxation, transfer payments to low-income groups, and jobs programs as means of narrowing the disparities in living standards among Americans and of eliminating the economic deprivation that violates the principles of democracy.

This book is a revised and expanded version of material presented in the Godkin Lectures at the John F. Kennedy School of Government of Harvard University in April 1974. This annual series, formally known as the Godkin Lectures on the Essentials of Free Government and the Duties of the Citizen, was established at Harvard in 1903 in memory of Edwin Lawrence Godkin (1831–1902). The author wishes to acknowledge the comments and criticisms of many friends and colleagues who read earlier drafts of the manuscript: Henry J. Aaron, Edward C. Budd, Robert Dorfman, Kermit Gordon, Alan Greenspan, Robert W. Hartman, George Jaszi, Irving Kristol, Donald S. Lamm, William D. Nordhaus, Joseph A. Pechman, George L. Perry, Alice M. Rivlin, Leonard S. Silk, Lester C. Thurow, and Murray L. Weidenbaum. Most of the research assistance (as well as valuable criticism) was provided by Joanne D. Culbertson; Nancy J.

Delaney ably completed those tasks and prepared the index. Evelyn P. Fisher contributed to the accuracy of factual material. With patience and precision, Mary F. Green prepared the many drafts of the manuscript. Mendelle T. Berenson provided perceptive editorial aid.

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KERMIT GORDON
President

March 1975
Washington, D.C.

Contents

CHAPTER ONE

Rights and Dollars

AMERICAN SOCIETY proclaims the worth of every human being. All citizens are guaranteed equal justice and equal political rights. Everyone has a pledge of speedy response from the fire department and access to national monuments. As American citizens, we are all members of the same club.

Yet at the same time, our institutions say "find a job or go hungry," "succeed or suffer." They prod us to get ahead of our neighbors economically after telling us to stay in line socially. They award prizes that allow the big winners to feed their pets better than the losers can feed their children.

Such is the double standard of a capitalist democracy, professing and pursuing an egalitarian political and social system and simultaneously generating gaping disparities in economic well-being. This mixture of equality and inequality sometimes smacks of inconsistency and even insincerity. Yet I believe that, in many cases, the institutional arrangements represent uneasy compromises rather than fundamental inconsistencies. The contrasts among American families in living standards and in material wealth reflect a system of rewards and penalties that is intended to encourage effort and channel it into socially productive activity. To the extent that the system succeeds, it generates an efficient economy. But that pursuit of efficiency necessarily creates inequalities. And hence society faces a tradeoff between equality and efficiency.

Tradeoffs are the central study of the economist. "You can't have your cake and eat it too" is a good candidate for the fundamental theorem of economic analysis. Producing more of one thing means using labor and capital that could be devoted to more output of something else. Consuming more now means saving less for the future. Working longer impinges on leisure. The crusade against inflation demands the sacrifice of output and employment—posing the tradeoff that now concerns the nation most seriously.

I have specialized throughout my career on the tradeoff between inflation and unemployment. To put it mildly, the search for a satisfactory way of managing it has not yet been successfully completed. I, for one, have not given up; indeed, I plan to spend the rest of my professional life on that problem. But in this essay I am wandering away from my usual concerns briefly to discuss an even more nagging and pervasive tradeoff, that between equality and efficiency. It is, in my view, our biggest socioeconomic tradeoff, and it plagues us in dozens of dimensions of social policy. We can't have our cake of market efficiency and share it equally.

To the economist, as to the engineer, efficiency means getting the most out of a given input. The inputs applied in production are human effort, the services of physical capital such as machines and buildings, and the endowments of nature like land and mineral resources. The outputs are thousands of different types of goods and services. If society finds a way, with the same inputs, to turn out more of some products (and no less of the others), it has scored an increase in efficiency.

This concept of efficiency implies that more is better, insofar as the "more" consists of items that people want to buy. In relying on the verdicts of consumers as indications of what they want, I, like other economists, accept people's choices as reasonably rational expressions of what makes them better off. To be sure, by a different set of criteria, it is appropriate to ask skeptically whether people are made better off (and thus whether society really becomes more efficient) through the production of more whiskey, more cigarettes, and more big cars. That inquiry raises several intriguing further questions. Why do people want the things they buy? How are their choices influenced by education, advertising, and the like? Are there criteria by which welfare can be appraised that are superior to the observation of the choices people make? Without defense and without apology, let me simply state that I will not explore those issues despite their importance. That merely reflects my choices, and I hope they are accepted as reasonably rational.

I have greater conviction in essentially ignoring a second type of criticism of the "more is better" concept of efficiency. Some warn that the economic growth that generates more output today may plunder the earth of its resources and make for lower standards of living in the future. Other economists have recently accepted the challenge of the "doomsday" school and, in my judgment, have effectively refuted its dire predictions.[1]

The concept of economic equality also poses its problems, which I shall explore more fully in chapter 3. Impressionistically, I shall speak of more or less equality as implying smaller or greater disparities among families in their maintainable standards of living, which in turn implies lesser or greater disparities in the distribution of income and wealth, relative to the needs of families of different sizes. Equal standards of living would not mean that people would choose to spend their incomes and allocate their wealth identically. Economic equality would not mean sameness or drabness or uniformity, because people have vastly different tastes and preferences. Within any income stratum today, some families spend far more on housing and far less on education than do others. Economic equality is obviously different from equality of opportunity, as I shall use the terms, and I shall explore that distinction further in chapter 3.

1. See William D. Nordhaus, "World Dynamics: Measurement without Data," *Economic Journal*, Vol. 83 (December 1973), pp. 1156–83; and Robert M. Solow, "Is the End of the World at Hand?" in Andrew Weintraub, Eli Schwartz, and J. Richard Aronson (eds.), *The Economic Growth Controversy* (International Arts and Sciences Press, 1973), pp. 39–61.

The presence of a tradeoff between efficiency and equality does not mean that everything that is good for one is necessarily bad for the other. Measures that might soak the rich so much as to destroy investment and hence impair the quality and quantity of jobs for the poor could worsen both efficiency and equality. On the other hand, techniques that improve the productivity and earnings potential of unskilled workers might benefit society with greater efficiency *and* greater equality. Nonetheless, there are places where the two goals conflict, and those pose the problems. The conflicts in the economic sphere will be discussed in chapter 2, which will analyze the ways that the market creates inequality and efficiency jointly, and in chapter 4, which will examine the ways that federal policy attempts to nudge the distribution of wealth and income generated by the market toward greater equality by such measures as progressive taxation, social insurance, welfare, and jobs programs.

In this chapter, I will examine the ways in which American society promotes equality (and pays some costs in terms of efficiency) by establishing social and political rights that are distributed equally and universally and that are intended to be kept out of the marketplace. Those rights affect the functioning of the economy and, at the same time, their operation is affected by the market. They lie basically in the territory of the political scientist, which is rarely invaded by the economist. But at times the economist cannot afford to ignore them. The interrelationships between market institutions and inequality are clarified when set against the background of the entire social structure, including the areas where equality is given high priority.

A society that is both democratic and capitalistic has a split-level institutional structure, and both levels need to be surveyed. When only the capitalistic level is inspected, issues concerning the distribution of material welfare are out of focus. In an economy that is based primarily on private enterprise, public efforts to promote equality represent a deliberate interference with the results generated by the marketplace, and they are rarely costless. When the question is posed as: "Should the government tamper with the market?" the self-evident answer is a resounding "No." Not surprisingly, this is a common approach among anti-egalitarian writers. Forget that the Declaration of Independence proclaims the equality of human beings, ignore the Bill of Rights, and one can write that only intellectuals—as distinguished sharply from people—care much about equality.[2] With these blinders firmly in place, egalitarianism in economics can be investigated as though it were an idiosyncrasy, perhaps even a type of neurosis.[3]

It is just as one-sided to view enormous wealth or huge incomes as symptoms of vicious or evil behavior by their owners, or as an oversight of an egalitarian society. The institutions of a market economy promote such inequality, and they are as much a part of our social framework as the civil and political institutions that pursue egalitarian goals. To some, "profits" and "rich" may be dirty words, but their views have not prevailed in the rules of the economic game.

To get a proper perspective, even an economist with no training in other social sciences had better tread—or at least tiptoe—into social and political territory. And that is where I shall begin. I shall travel through the places where society deliberately opts for equality, noting the ways these choices compromise efficiency and curb the role of the market, and examining the reasons why society may choose to distribute some of its entitlements equally. I shall focus particularly on some of the difficulties in establishing and implementing the principle that the equally distributed rights ought not to be bought and sold for money.

2. Irving Kristol, "About Equality," *Commentary*, Vol. 54 (November 1972), pp. 41–47.

3. Harry G. Johnson, "Some Micro-Economic Reflections on Income and Wealth Inequalities," *Annals of the American Academy of Political and Social Science*, Vol. 409 (September 1973), p. 54. Johnson attributes the concern with inequality, in part, to "a naive and basically infantile anthropomorphism."

THE DOMAIN OF RIGHTS

A vast number of entitlements and privileges are distributed universally and equally and free of charge to all adult citizens of the United States. Our laws bestow upon us the right to obtain equal justice, to exercise freedom of speech and religion, to vote, to take a spouse and procreate, to be free in our persons in the sense of immunity from enslavement, to disassociate ourselves from American society by emigration, as well as various claims on public services such as police protection and public education. For convenience, I shall call all of these universal entitlements "rights," recognizing that this is a broader use of the term than most political theorists employ and that it lumps together freedom of speech and free access to visit the Capitol.

Rights have their negative side as well, in the form of certain duties that are imposed on all citizens. For example, everyone has a responsibility to obey the law—anyone who would merely balance the cost of risking a prison sentence against the benefits obtainable from stealing a wallet is violating that duty. Military conscription and jury service are examples of duties assigned—in principle, if not always in practice—by random selection and not according to the preferences or status of individuals.

Features of Rights

An obvious feature of rights—in sharp contrast with economic assets—is that they are acquired and exercised without any monetary charge. Because citizens do not normally have to pay a price for using their rights,[4] they lack the usual incentive to economize on exercising them. If the fire depart-

4. Money may be relevant indirectly. Visiting the Capitol involves the cost of transportation. More seriously, the cost of obtaining equal justice before the law creates problems discussed later in this chapter.

ment charged for its services, people would be at least a little more reluctant to turn in an alarm and perhaps a bit more systematic about fire prevention. If speaking out on public issues had a price tag, citizens might be more thoughtful before they sounded off—and perhaps that would improve the quality of debate. But society does not try to ration the exercise of rights.

Second, because rights are universally distributed, they do not invoke the economist's principle of comparative advantage that tells people to specialize in the things they do particularly well. Everybody can get into the act, including some who are not talented actors. Some people with great skill in their civilian pursuits make hopelessly inept soldiers; thus, the draft cannot provide the most efficient army, yet it is the way we raise wartime military forces. Surely, voters do not have equal ability, equal information or education, or an equal stake in political decisions. Since those decisions are concentrated on taxing and spending, property owners and taxpayers may have a greater stake in them; that relative difference is ignored in the acceptance of universal suffrage. We have dismissed Edmund Burke's contention that a limitation of suffrage to property owners might help to ensure a thoughtful approach to social policy.[5] Similarly, although children are excluded from voting rights, we forgo the use of even a minimum test of competence like literacy as a qualification.

We have rejected John Stuart Mill's proposal that differential voting powers should be based on achievement and intelligence, despite his insistence that such a system was "not . . . necessarily invidious . . ."[6] Recently, a writer on the op-ed page of the *New York Times* reinvented Mill's wheel, proposing a "system of proportional representation that would weight each man's vote in proportion to his demon-

5. Edmund Burke, *Reflections on the Revolution in France* (1st ed., 1790; Penguin Books, 1969), pp. 140–41.

6. John Stuart Mill, *Considerations on Representative Government* (1st ed., 1875; Bobbs-Merrill, 1958), p. 136.

strated capability to make intelligent choices."[7] Such proposals imply that the division of labor is relevant to the distribution of voting rights, and given that fundamental premise, they might make sense. But rejecting that premise, many of us find them preposterous.

A third characteristic of rights is that they are not distributed as incentives, or as rewards and penalties. Unlike the dollar prizes of the marketplace or the nonpecuniary honors and awards elsewhere, extra rights and duties are not used to channel behavior into socially constructive pursuits. In principle, people could be offered extra votes or exemptions from the draft in recognition of outstanding performance, and those rewards might serve as added incentives to productive achievement. But only in a few limited and extreme cases, like the loss of the right to vote by convicted felons, does society establish a quid pro quo in the domain of rights.

A century ago, that advocate of thoroughgoing laissez-faire, Herbert Spencer, opposed a host of universally distributed public services, resting his criticisms on several grounds, including disincentive effects. Even public libraries drew his scorn.[8] After all, they offer people real income without requiring any effort in return. Indeed, free books may be doubly damned because they are a form of real income that increases the value of leisure. Spencer certainly was revealing some bizarre social attitudes, but he had a point in recognizing the inefficiency of rights.[9]

Fourth, the distribution of rights stresses equality even at the expense of equity and freedom. When people differ in capabilities, interests, and preferences, identical treatment is not equitable treatment, at least by some standards. It would be hard to defend the provision of public education out of

7. Joseph Farkas, "One Man, 1/4 Vote," *New York Times*, March 29, 1974.

8. Herbert Spencer, *The Man versus the State* (Appleton, 1884), p. 33.

9. To be sure, the efficiency argument is not clear-cut for public libraries, since access to books may build human capital.