Talk 2: INCOME DISTRIBUTION and ECONOMIC DEVELOPMENT

1. Somewhat surprisingly, income distribution questions excite relatively little interest in economics.

   Most discussion is focussed on questions of economic efficiency (not equity).

2. Nonetheless, once you enter the work force you will start taking a much greater interest in such questions.

   How much will you be paid, and how much should you be paid?

   How much tax will you pay, and how much should you pay?

3. Why do questions of income distribution tend to be left aside relative to questions of efficiency?

   In large part, the answer is that according to economic theory (the first fundamental law of welfare economics) issues of efficiency can be looked at independently of issues of distribution (ie efficiency and equity are separable).

   But like all economic theories, this premise is based on certain assumptions – which may not hold in practice.

4. Consider issues of both
   (i) domestic income distribution, and
   (ii) international income distribution.

5. Domestic income distribution:
   (i) How much should you be paid?
       Orthodoxy theory says we are paid our worth ie our marginal products.

   (ii) Is it always easy to identify, measure and reward marginal product (MP)?
       Not at all.
       What are the MPs of your respective school teachers? Are they paid accordingly?

   (iii) MP is of obvious relevance. Brain surgeons are paid more than street sweepers for good reason.
       But is something more involved?
(iv) J.K. Galbraith long argued that economics considers the economics of everything – except power. He argued that POWER is a determinant of income distribution, not just MP.

(v) Note the recent publicity/scandal regarding the enormous salary packages many corporate CEOs have managed to secure for themselves – even when they were leading their companies to disaster. What was the MP of the leaders of such failed companies (consider HIH, Enron or AMP for example)? These corporate salary packages reflected an attempt to solve an economic problem to the advantage of shareholders – a principal/agent problem – but shareholders associations are obviously unpersuaded that this “solution” actually worked.

(vi) Note too the animosity to trade unions – which are condemned by many economists as an interference with competitive behaviour in labour markets. If one takes the academic labour market, it is obvious that there are interferences with competitive behaviour in the labour market on the employer side as well, insofar as the federal government effectively has monopoly power over the ownership of Australia’s universities. Are trade unions bad, per se? Or are they a counterbalance to monopoly power and business concentration on the other side of the labour market?

(vii) TAX POLICY is a major influence over income distribution. What is the highest effective marginal tax rate you believe has been exacted in Australia in the last decade or two? Most people say 50-60%. they also say that it has been imposed on the rich. That is wrong on both counts. The poor have sometimes paid an effective marginal tax rate of over 100%.

(viii) SOME PRESENT CONTROVERSIES:

(a) Family income tax. Should the basic tax unit be the individual or the individual family?
(b) Paid maternity leave is now on the agenda. Who gains and who loses from such a policy? If income tax goes down and HECS goes up, did you gain or lose? More generally, government
expenditure policy has to be considered alongside tax policy, since what you get for your tax may be changing along with your tax rate.

(c) Is the Australian tax system a “good” one?

(d) Many would say “NO” – on all three relevant grounds of horizontal equity, vertical equity, and simplicity.

(e) Do wage and salary earners pay a disproportionately large share of total tax accruals?

(f) Is Australia becoming more egalitarian or more inegalitarian?

6. International income distribution:

   (i) What proportion of the world’s population lives on less than US$1 per day?

   (ii) Do the rich countries help the poor countries to overcome poverty by donating significant foreign aid?

   (iii) Does that foreign aid actually work (ie does it increase growth rates in recipient countries)?

   (iv) Is there such a thing as anti-aid?

       (a) Is the foreign trade game rigged? ......

       (b) European Union agricultural subsidies ..... 

       (c) Note the case of the small Pacific Islands and the OECD campaign against “unfair tax competition”.

   (v) The international case for “a level playing field”, and the case of Filipino cattle subsidies. The Philippines has discontinued a domestic poverty alleviation scheme which was deemed to be distorting world cattle trade by virtue of subsidies to some impoverished farmers. Meanwhile the 2002 US Farm Subsidy Bill increased already large subsidies to US farmers.

   (vi) Do international income distribution policies matter? Eg are they related to anti-Americanism and world terrorism? Critics of American/EU policies certainly charge the USA and others with hypocrisy in respect of some trade reform policies (ie increasing their own agricultural subsidies at the expense of people in poor countries).