

# Theories of Distributive Justice: Frameworks for Equity

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## Abstract

In the wake of the global economic crisis of 2008/09 public concern has focused on inequities within society. Over the period leading up to the economic crisis, Western liberal democracies adopted market based economic policies that allowed disparities between the income and wealth of the highest and lowest income earners to flourish.

The tax transfer system is one of the tools available to governments to regulate such inequities: progressive tax systems can apply higher taxes to those with a greater ability to pay, while transfer systems can redistribute taxes to those in need.

However, fairness is a subjective assessment based on morals and ethics as interpreted by economists and policymakers. Why does society agree to redistribution through the tax system, and to what extent is redistribution justified? How have concepts of distributive justice evolved, and to what extent do these concepts reflect culture and prevailing economic theories?

In this article I review four major theories of distributive justice that can be applied to interpret equity. I draw extensively on the views of several prominent 20<sup>th</sup> century economists and philosophers who represent different schools of economic thought: Robert Nozick (libertarianism), the utilitarians, John Rawls' 'Theory of Justice' and Amartya Sen's capabilities approach.

The purpose of this review is to make these theories accessible to students of tax policy in order to assist them in understanding how the values and ethical positions taken by policymakers can impact on fairness and equity in the tax transfer systems.

## Introduction

The concept of economic equality is hard to define or to measure. It might be impossible to recognise complete equality if it existed; but inequality is very easy to recognise.<sup>1</sup>

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<sup>1</sup> Arthur M Okun, *Equality and Efficiency: The Big Tradeoff*, The Godkin Lectures (The Brookings Institute, 1975).

While there are a number of formulations as to what is required of a ‘good’ taxation system,<sup>2</sup> we are accustomed to including efficiency, equity and simplicity as essential criteria. The difficulty with the concept of equity is in understanding exactly what is meant by the term. While efficiency and simplicity are measurable, equity is a subjective concept, capable of different interpretation depending on the moral and ethical frameworks, the experiences and the understanding of the person making the interpretation.

However, there is a clear perception in the community that inequality is growing, and that the structure of the tax transfer system contributes to this inequity.<sup>3</sup>

Taxation, including tax policy principles, is generally taught within law and business degrees, with a focus on the black letter legal and constitutional principles or the economic impact of particular policy directions. There is rarely scope in such programs to step back and examine the moral and ethical underpinnings of the tax and transfer system and to locate this inquiry in philosophies of distributional justice. A consequence of this is that students who encounter the concept of equity in reading tax policy may not recognise that it may mean different things to different writers. For example, readers need to recognise and interpret some of the underlying issues, including:

- the choice of indices to use when attempting to measure distributional shifts;
- whether equity should be measured by reference to the needs of society or the individual, balancing any competition between those needs;
- how the policy settings of the tax transfer system should be adjusted to achieve a preferred equitable distribution of resources; and
- the role of the institutions within a given society in helping to decide some of these questions.

Equity is a fundamental consideration in the development or review of tax policy in conjunction with economic efficiency, simplicity and international competitiveness. The taxation system is used by governments as a tool to improve the welfare of society, whether through the implementation of economic programs that will have a beneficial impact or through the raising of money for direct redistribution. However, there are variations in political and

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<sup>2</sup> See, eg, K W Asprey, ‘Taxation Review Committee Full Report’ (1975); Adam Smith, *The Wealth of Nations* (1776, Petersfield Harriman House, 2007 available at <[www.netlibrary.com](http://www.netlibrary.com)>); J E Meade, ‘The Structure and Reform of Direct Taxation’ (Allen & Unwin, 1978); Australian Treasury, ‘Architecture of Australia’s Tax and Transfer System’ (Australian Government, 2008).

<sup>3</sup> OECD, *Growing Unequal? Income Distribution and Poverty in OECD Countries* (OECD, 2008).

economic views on what equity means, and the best way to deliver equitable outcomes in policy.

We can break down the concept of equity into different aspects. Traditionally taxation issues have been explored through the concepts of vertical equity, which requires that people earning more should pay more tax, and horizontal equity, which is the understanding that persons earning the same should pay the same tax. Modern theorists will also consider other subgroups within the community that face particular systemic challenges, such as gender equity, queer equity or indigenous equity.

The field of welfare economics is concerned with examining the impact of economic policy on social welfare. Much of the literature in this field tends to be concerned with the measurement of shifts in social welfare,<sup>4</sup> or of the distribution of resources throughout society. In particular, the economists Lorenz and Atkinson developed the Lorenz Curve and the Atkinson Index respectively, as measures of income inequality based on the distribution of income among the population that use shifts in the distribution to measure improvements in social welfare.

However, such normative measures are not the concern of this paper. In this paper I will examine a number of theories of distributive justice and their relevance in designing social policies, particularly tax transfer regimes. This strays beyond the realm of economists into political philosophy because it requires an examination of the moral and ethical philosophies that underpin theories of justice.

The various theories of distributional justice that students are most likely to encounter in their reading are all derived from liberal theory, and much of the debate stems back beyond the age of enlightenment: references to John Locke, John Stuart Mill, Jeremy Bentham and Rene Descartes all appear regularly in the modern debate.

Andersson<sup>5</sup> identifies three stages of moral theory: ‘real freedom for all’, ‘democratic community’ and the emerging area of ‘sustainable development’:

‘Real freedom’ is a value formulated on the level of the individual. ‘Democratic community’ is a value pertaining to a collective of people. ‘Sustainable development’

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<sup>4</sup> Jonathan R Kesselman and Ron Cheung, ‘Tax Incidence, Progressivity and Inequality in Canada’ (2004) 52(3) *Canadian Tax Journal* 709.

<sup>5</sup> Jan Otton Andersson, ‘Real Freedom, Democratic Community and Sustainable Development as Fundamental Values in Economic Enquiry’ in Ralf Eriksson and Markus Jantti (eds), *Economic Value and Ways of Life* (Avebury, 1995) 157.

relates to the global and ecological system as a whole. It is hardly possible to derive one of these values directly for the other two. There are genuine conflicts between them ... this means that we are often unable to say which ethical position or political solution is preferable in any absolute sense; we have to accept valuational differences and ethical compromises.<sup>6</sup>

I will examine these issues through the writings of four 20<sup>th</sup> century philosophers and economists who represent four modern theories of distributive justice: Robert Nozick represents the libertarian view; the utilitarians including John Harsanyi; John Rawls' 'Theory of Justice';<sup>7</sup> and Amartya Sen's capabilities approach. The debate between these contemporaries is a rich source of material.

To apply Andersson's typography to these philosophers: libertarians are recognised as free market philosophers focused on individual rights, but Sen also believes that freedom is obtained by allowing individuals the freedom to maximise their own capability, and resource reallocation must be a means toward that end. Democratic communities are represented by the utilitarian school, which looks toward the greater good for the greatest number of people but also by John Rawls' 'Theory of Justice' which is based on a social contract between members of society.

In this paper I will begin by examining the difference between the concepts of equity, equality and distributive justice. I will then outline the four theories of distributive justice that have had most impact over the past four decades: libertarianism, utilitarianism, Rawls' 'Theory of Justice'<sup>8</sup> and Sen's capability framework. The next section of this paper will contrast these theories, drawing on contemporary discussion between the various proponents to identify key points of difference. Finally, the conclusion will place this debate in the context of current trends in growth in inequality and the global financial crisis of 2008/09.

### **Equity, equality and distributive justice**

Equity in the economic context can be broadly defined as fairness, based on the access to, or distribution of, the resources necessary for welfare:

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<sup>6</sup> Ibid 160.

<sup>7</sup> John Rawls, *Justice as Fairness: A Restatement* (Harvard University Press, 2001) (referred to as the 'Theory').

<sup>8</sup> Ibid.

Equity is a general concept that can be given alternative meanings when formalized. As a general concept it refers to the belief that the distribution of economic welfare matters, and that increasing the equality of distribution is a laudable objective.<sup>9</sup>

In order to establish the preferred distribution of economic welfare, economists and philosophers refer to theories of distributive justice. These theories examine the extent to which resources are distributed throughout society:

Principles of distributive justice are normative principles designed to guide the allocation of the benefits and burdens of economic activity.<sup>10</sup>

As Roemer notes<sup>11</sup>, the work of economists and philosophers in this field is entwined:

The economist's way of thinking can check the consistency of a philosophical theory or provide a concrete formulation (a model) to make precise some of its still vague assertions ... The key new concepts in the last thirty years in the theory of distributive justice — primary goods, functioning and capability, responsibility in its various forms, procedural versus outcome justice, midfare — have all come from the philosophical way of thinking.<sup>12</sup>

In the context of the tax transfer system, equity is usually considered under the two criteria of vertical equity and horizontal equity. They have been described as 'refinements of the ability to pay principle'<sup>13</sup>. While horizontal equity requires that people in the same economic position should pay the same tax, people in a different economic situation should be treated differently. The major difficulty is in determining what is meant by the 'same' or 'different' economic position. Other criteria, such as gender or race, can also be applied in examining equity or distributive justice.

To what extent does equity require equality? The term equity is usually used in preference to equality because the only society in which people could be regarded as truly equal would be the perfect egalitarian ideal aimed for by philosophers such as Karl Marx. The reality of the

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<sup>9</sup> J Black, N Hashimzade and G Myles, *A Dictionary of Economics* (Oxford University Press, 2009), <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t19.e1025>>.

<sup>10</sup> Julian Lamont and Christi Favor, 'Distributive Justice' in *The Stanford Encyclopedia of Philosophy* (Fall 2008 edition), <<http://plato.stanford.edu/archives/fall2008/entries/justice-distributive/>>.

<sup>11</sup> John E Roemer, *Theories of Distributive Justice* (Harvard University Press, 1996).

<sup>12</sup> Ibid 3.

<sup>13</sup> Australian Treasury, above n 2, 180.

experience with communism shows that even a society that claims equality of all citizens through redistribution of resources cannot ensure true equality of all citizens.

Other than a handful of ‘strict egalitarians’, few theorists argue that equality is achievable — or even desirable. Modern egalitarian theory seeks a more equal distribution of resources, rather than seeking an equal distribution.

Equality as such may not be the most appropriate system to ensure that economic activity is directed to maximise welfare of specific individuals, groups of individuals or a society as a whole.

While access to income and wealth are an important determinant of a person’s welfare, there are other characteristics that will affect on a person’s welfare. John Rawls in the ‘Theory’<sup>14</sup> refers to three factors that shape a person’s access to resources:

1. Social factors: a person’s class of origin can ensure access to resources including wealth and power;
2. Natural factors: a person may have inherent natural endowments that can be fully exploited given the opportunity; and
3. Fortuitous factors: a person may encounter circumstances that limit or enhance access to resources from time to time, such as ill health, unemployment or winning the lottery.

Redistribution of income and wealth may enhance or ameliorate these factors: for example, a person with a natural talent as an artist may need assistance to allow them to fully explore and develop this talent; or transfer payments may be available to assist a person who is facing financial difficulties as a result of ill health or unemployment. However, equality may not be achievable due to limitations in one or more of the three factors.

Accordingly, the concept of equity is generally now seen as more appropriately referring to ensuring that all have a sufficiency of resources, being money or wealth, to meet their needs. However, even this requires subjective judgments: as wealth within a society increases, so do the demands of all within that society — including those who are not wealthy.<sup>15</sup> Thus the focus shifts to the distribution of resources within the society.

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<sup>14</sup> Rawls, above n 7.

<sup>15</sup> Smith, above n 2, Book 2 Chapter 3.

Amartya Sen developed a capability framework to consider equality, which extends beyond the economic issues of equity. Sen<sup>16</sup> argues that the specific factors that affect whether a person can access the resources allocated to them must be taken into account in determining equity:

A person less able or gifted in using primary goods to secure freedoms, (e.g. because of physical or mental disability, or varying proneness to illness, or biological or conventional constraint related to gender) is disadvantaged compared with another more favourably placed in that respect even if both have the same bundle of primary goods.<sup>17</sup>

As expressed in his most recent book:<sup>18</sup>

In contrast with the utility-based or resource-based lines of thinking, individual advantage is based in the capability approach by a person's capability to do things he or she has reason to value. A person's advantage in terms of opportunities is judged to be lower than that of another if she has less capability — less real opportunity — to achieve those things that she has reason to value. The focus here is on the freedom that a person actually has to do this or be that — things that he or she may value doing or being ... [The capability approach] is thus linked closely with the opportunity aspect of freedom, seen in terms of 'comprehensive' opportunities, and not just focusing on what happens at 'culmination'.<sup>19</sup>

Accordingly, capability becomes an important consideration in the distribution of resources: does the recipient have the capability to utilise the resources to improve his position, and are the resources that are made available to the recipient the appropriate resources to maximise his capability?

### **Theories of distributive justice**

There are a number of theories of distributive justice that view the issue of equity through a coherent framework. This paper compares libertarianism, utilitarianism, Rawls' 'Theory' and the capability approach as expressing a range of modern views. At different periods, and within different economic and political regimes, different views have achieved pre-eminence among policymakers.

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<sup>16</sup> Amartya Sen, *On Economic Inequality* (Clarendon Press, 1973).

<sup>17</sup> Ibid 148.

<sup>18</sup> Amartya Sen, *The Idea of Justice* (Allen Lane, 2009).

<sup>19</sup> Ibid 231–2.

These theories stem from the liberal tradition, which values liberty and equality: ‘The core substantive principle of liberalism is this: *As many people as possible should have as much say as is feasible over the direction their lives will take.*’<sup>20</sup> Although egalitarianism in its strict form is the exception in that it is more collective in its outcomes, the contribution of Rawls in the ‘Theory’<sup>21</sup> and other modern egalitarian philosophy is grounded in liberal ideology. The different approaches discussed try to balance three views of the allocation of resources, which can be defined as follows:

- Deserts (or merits): a person deserves a particular allocation of resources. Generally the theory of deserts reflects merit or effort because a person has acted in a manner that enhances their resource allocation. It is argued that recognition of deserts is necessary to ensure efficiency as people are rewarded for effort. Within the tax transfer system this discussion is often considered in the context of disincentive effects, for example through the application of high marginal tax rates or the withdrawal rates for benefits — a person may limit their participation in the labour market because they do not consider that they are receiving adequate reward for their effort.
- Entitlement: a person is entitled to an allocation of resources. This concept is related to deserts because a person who deserves an allocation will also be entitled to those resources. However, it also encompasses holdings that may be accumulated through other legal means, such as inheritance or market purchase. The discussion over capital or wealth taxation encompasses the notion of entitlement. While some would argue that unearned income should be taxed at higher rates, others contend that the taxation of capital or wealth interferes with productivity by limiting investment in productive assets.
- Needs: in contrast to deserts and entitlements, a needs based allocation of resources will give priority to ensuring that a person is allocated sufficient resources to meet their needs. It raises the problem of determining the base level of resources that a citizen needs to support a useful life, either as a class or in the case of a particular individual. The needs principle is inherent in income support systems.

A welfare system contemplates redistribution of resources among citizens, generally based on need. However, deserts and entitlements will be taken into account to a varying extent, depending on the priorities that are applied in the design of the system. For example, income

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<sup>20</sup> Alan Wolfe, *The Future of Liberalism* (Alfred A Knopf, 2009) 10.

<sup>21</sup> Rawls, above n 7.



support systems that are based on a social security contribution will incorporate elements of deserts, entitlement and needs based ideologies. To the extent that a person has contributed to the system, they are deserving of and entitled to support. However, there will still be a safety net level of support available for those who have not contributed but are in need of income support. It is worth noting that it is rare to implement a theoretical framework in an ideal form.<sup>22</sup> For example, a neoliberal economy will still have some level of redistribution based on need — but the desert and entitlement principles will be more prominent than in a socialist economy.

### **Libertarianism/neoliberals**

Libertarians and neoliberals regard the rights of individuals as taking primacy over any collective rights of society. Further, they believe this is best achieved through the free operation of the market. Clearly this can lead to a broad range of political views, ranging from anarchism to free thinking liberalism. Friedrich Hayek drew a distinction between true individualism, which argues that ‘if left free, men will achieve more than individual human reason could design or foresee’<sup>23</sup> and the Cartesian school in which individualism is seen as a form of social contract. Hayek argues that the latter form of individualism in fact leads to socialism because a condition of free society is to treat all individuals equally.

In its economic context, libertarians believe that the market mechanism allows the operation of free will by participants in the market. If the market mechanism operates freely, producers and purchasers have the choice as to whether to trade at the set price. It is the exercise of choice that allows the market to find equilibrium. Accordingly, an individual establishes their own economic wellbeing through the exercise of choice. In its purest form, there is no scope for government intervention in libertarian theory.

Hayek, in his essay on individualism, says that:

When we turn to equality, however, it should be said at once that true individualism is not equalitarian in the modern sense of that word. It can see no reason for trying to make people equal as distinct from treating them equally.<sup>24</sup>

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<sup>22</sup> Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press, 2002).

<sup>23</sup> Friedrich A Hayek, *Individualism and Economic Order* (Routledge & Kegan Paul Ltd, 1949) 11.

<sup>24</sup> Hayek, above n 23, 30.

Robert Nozick applied entitlement theory in rejecting the concept of government intervention to redistribute resources because the market is the appropriate redistributive mechanism:

There is no central distribution, no person or group entitled to control all the resources, (jointly) deciding how they are to be doled out. What each person gets, he gets from others who give to him in exchange for something or as a gift. In a free society, diverse persons control different resources, and new holdings arise out of the voluntary exchanges and actions of persons.<sup>25</sup>

Similarly, Nozick rejects taxation as being on a par with forced labour because a person is forced to work to earn money to pay taxes which will be reallocated according to some principle that is not chosen by the taxpayer.<sup>26</sup>

In his essay Nozick explored the libertarian framework through the entitlement theory, arguing that as people can be entitled to holdings of capital as well as to earnings, in a free market based society they have the right to transfer those holdings to another person — in which case the transferee becomes entitled to the property, and prima facie this is the only valid method of transferral. ‘Justice in holdings is historical; it depends upon what actually has happened.’<sup>27</sup> There is a modification to this principle where the acquisition of the rights in the asset may interfere with the liberty of others to use an asset that was freely available and is necessary to life, such as a waterhole. Drawing on Locke’s Theory of Acquisition, a person’s rights to deal with such property should be restricted, and there is a role for state intervention in such cases.<sup>28</sup>

Nozick argued that welfare economics disregards the historical nature of entitlements, looking only at the current distribution of resources. He rejected patterned distributions, redistributions that are allocated to accord with some moral principle — whether merit, needs, effort or some other chosen principle — claiming that any such patterning can be overturned by the participants who may choose an alternative distribution and exercise that choice through the market mechanism.

## **Utilitarianism**

Utilitarianism measures the welfare of society as the sum of the utilities of all members of that society. The basic principle was summed up by Jeremy Bentham as ‘that principle which

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<sup>25</sup> Robert Nozick, ‘Distributive Justice’ (1973) 3(1) *Philosophy and Public Affairs* 45, 46.

<sup>26</sup> Nozick, above n 25, 65.

<sup>27</sup> Nozick, above n 25, 48.

<sup>28</sup> Nozick, above n 25, 70–8.

approves or disapproves of every action whatsoever, according to the tendency it appears to have to augment or diminish the happiness of the party whose interest is in question: or, what is the same thing in other words, to promote or to oppose that happiness.’<sup>29</sup> Accordingly if the welfare of an individual within that society increases, as long as the decrease in the welfare of other individuals is less than the increase of the member who benefits, then the welfare of society as a whole has increased. To illustrate: if a millionaire pays an additional \$1000 in tax, and this is transferred to health services for low income earners, society will be better off because the marginal utility of the low income earners who use the service has increased by at least as much as the marginal utility of the millionaire has decreased.

The field of welfare economics is largely based on utilitarian philosophy, as it is concerned with ensuring that resources are allocated among a community to maximise the welfare of that community. Unlike egalitarianism, utilitarianism does not require the redistribution of resources to ensure that all citizens have equal resources. However, it is distinguished from libertarianism because it does acknowledge that redistribution may be required to maximise the welfare of the community ahead of the interests of individuals, and the state will intervene to facilitate this redistribution.

It is this concept of summing the utilities of all members within a society to measure the welfare of the society that both enables measurement of a society’s welfare and gives rise to criticism because the summation can disguise individual movements in welfare. One of the criticisms of utilitarianism is that the measurement of aggregate utility does not take into account the relative position of the winners and losers in the transfer. For example, in relation to education or health a private, user pays system may operate in parallel with a government funded system. When the government makes a co-contribution to the cost of such schools or medical treatment the funding comes from taxes, which spreads the cost across the entire community. However the beneficiaries are the users of the private service, who are often higher income earners. In contrast, when funding is provided to government schools or medical services, the whole community has access.

Transaction costs are significant in the utilitarian analysis because the leakage that may occur through such costs can reduce the benefit to the extent that there is no longer any improvement in the overall welfare of the society. This was explored by Okun in his ‘Leaky-Bucket’

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<sup>29</sup> Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation* (Clarendon Press, 1907), Library of Economics and Liberty, <<http://www.econlib.org/library/Bentham/bnthPML1.html>>.

experiment,<sup>30</sup> which explored the extent to which a person will accept inefficiencies in the transfer between the donor and the recipient in a tax transfer arrangement, using the analogy of a bucket that leaks while transferring benefits from the rich to the poor. While most people would agree to the transfer if the total amount was made available to the beneficiaries of the program, opinion will change if inefficiencies in the program reduce the amount that is made available. Okun makes the point that this will be a personal judgment made by the observer:

If your answer, like mine, lay somewhere between 1 and 99%, presumably the exact figure reflected some judgement of how much the poor needed the extra income and how much the rich would be pinched by the extra taxes.<sup>31</sup>

Pareto optimality, which is fundamental to utilitarian redistribution concepts, is the equilibrium position that is reached where the overall utility of a society is maximised; that is, any further increase in the welfare of one person will result in a decrease in the welfare of someone else. This requires an understanding of social choice theory, which examines how collective decisions are formed and ranked based on the values held by individuals, and has been described as ‘the aggregation of the multiplicity of individual preference scales about alternative social actions’.<sup>32</sup> The utilitarian view focuses on welfare as a collective function, yet it is based on the values of individuals, and respects the autonomy of individuals within the context of striving for the common good.<sup>33</sup>

Arrow’s Impossibility Theorem<sup>34</sup> shows that when individual preferences are aggregated to develop a social welfare function the final determination of the policy will be made by a nominated person. The theorem states that any social welfare function that meets the following conditions:

- 1) The collective preference order is based on a set of individual preferences (unrestricted domain);
- 2) The pareto condition is met; and
- 3) The individual preferences are based solely on the alternatives available

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<sup>30</sup> Okun, above n 1.

<sup>31</sup> Okun, above n 1, 94.

<sup>32</sup> Kenneth Arrow, ‘Values and Collective Decision Making’ in F H Hahn and Martin Hollis (eds), *Philosophy and Economic Theory* (Oxford University Press, 1979) 110.

<sup>33</sup> John C Harsanyi, ‘Morality and the Theory of Rational Behavior’ (1977) 44(4 Winter) *Social Research* 623.

<sup>34</sup> Kenneth Arrow, *Social Choice and Individual Values* (Wiley, 1951).

Cannot also meet a fourth condition:

- 4) An individual cannot override the preferences of the others (non-dictatorship).

While this person is called a dictator in the theorem, it may well be an elected politician, cabinet minister or secretary who holds the ultimate power. Utilitarians rely on the theory that decision makers act rationally when making economic and distributional decisions. Game theory is used in economics to predict how individuals would act in specific circumstances, and has shown that in making moral judgments a rational person will disregard self-interest because they can clearly differentiate a self-interested position from a position of general moral application. The morality of a decision can be viewed individually in terms of the specific act (act utilitarianism) or in terms of the general rules that apply when making decisions (rule utilitarianism). Although a person will frequently express an irrational or illogical desire, this expressed preference can be differentiated from the true preference, which can only be determined when the person has access to all relevant information. The decision will ultimately be based on moral preferences combined with rational understanding of outcomes.<sup>35</sup>

### **Egalitarianism**

The philosophy that comes closest to equating equality with equity is egalitarianism, and in its strict form it moves further from the liberal tradition than the other philosophies under review. Egalitarians argue that society should strive to ensure equality for all people, and income and wealth should be shared equally among all. The two major arguments against egalitarianism are firstly that effort is not recognised; and secondly that redistribution of wealth and resources will only go part of the way to creating equality because natural skills and luck cannot be redistributed.

The first argument raises the issue of deserts and reward: that rewarding a person for their contribution will encourage participation. In order for an economy to function efficiently, freeloading must be discouraged and production encouraged. If every person is guaranteed an equal share of the output then there is no encouragement to increase levels of production above a base level. Further, there is no incentive to contribute if resources are to be shared equally irrespective of input to the process. Although Karl Marx was an egalitarian, he did recognise the need to reward participants. Marx was primarily concerned with the reform of production, through the dismantling of capitalism: from each according to his ability, to each according to

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<sup>35</sup> Ibid 33.

his need.<sup>36</sup> The redistribution of wealth would follow the reform of production and was a second stage in economic reform. Accordingly, he argued that every person has a right to get back what they have put in: if a person puts in more, they are entitled to receive more. It is only when production reform has been implemented, so that the distinction between capital and labour inputs is no longer significant and the overall wealth of society has increased, that the second stage can proceed: in the first phase of socialism, the analysis of exploitation addresses the issue of desert, while the second phase addresses the issues of need.<sup>37</sup>

The distribution of natural skills, resources and chance has been explored by modern egalitarian theorists who have been concerned with the moral frameworks that underpin redistribution of resources, although these frameworks will usually not result in an 'equal' allocation of resources. Egalitarian theories can be categorised as resource based or welfare based,<sup>38</sup> with a further development of egalitarian theory, known as 'luck egalitarianism' focusing on the role of chance in resource allocation. Resource based philosophers, including Dworkin and Rawls, argue that resources — whether material resources or rights — should be distributed to maximise opportunities for all citizens, whereas welfare based egalitarianism is more concerned with ensuring that the welfare of all citizens is equalised: the difference in approach is in relation to inputs as opposed to outcomes. Sen falls into the second category, although his capability theories are based on allowing individuals to choose between options, as do libertarians; and in spite of his criticism of utilitarianism, Sen's theories require some consideration of social benefit when making decisions in relation to the efficient distribution of resources.

The role of chance, or luck, in the distribution of resources is problematic to egalitarians. While natural skills can be developed and used in particular ways, and material resources can be redistributed through government intervention, the role of chance is more difficult to evaluate and adjust. Luck egalitarians distinguish between outcomes that are chosen and outcomes that are forced upon the recipient:

In my view, a large part of the fundamental egalitarian aim is to extinguish the influence of brute luck on distribution ... Brute luck is an enemy of just equality, and, since

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<sup>36</sup> Karl Marx, *Critique of the Gotha Program (Part 1)* (1875; Progress Publishers, 1970), <<http://www.marxists.org/archive/marx/works/1875/gotha/ch01.htm>>.

<sup>37</sup> Amartya Sen, *Inequality Reexamined* (Oxford University Press, 1992).

<sup>38</sup> Mark S Stein, *Distributive Justice and Disability: Utilitarianism Against Egalitarianism* (Yale University Press, 2006).

effects of genuine choice contrast with brute luck, genuine choice excuses otherwise unacceptable inequalities.<sup>39</sup>

Luck egalitarians seek to address the inequalities that may arise from circumstances that a person does not choose: redistribution is seen as a way of addressing bad fortune, rather than as a means to remove good fortune.

### **Rawls: the social contract**

Rawls approach is based on the theory of social contract, which postulates that individuals enter into a contract with society, and that their rights and obligations to society are based on this contract. Equity and justice flow from this contract. The origins of this theory can be seen in the Cartesian school of philosophy, which was criticised by Hayek<sup>40</sup> as leading to collective decision making and socialism.

While Okun discusses the trade-off that may be required between equity and efficiency,<sup>41</sup> Rawls gives priority to equity, even where the outcomes are inefficient.

The contribution of Rawls to the debate on equality was first published in 1971.<sup>42</sup> He continued to review and revise the 'Theory' until his death in 2002.<sup>43</sup> He essentially regarded equality as a function of the pluralistic society in which we participate. Participants in society form a social contract that allows them to participate fully as long as they observe the rules of that society; however, the rules must be seen to be fair before people will accept the contract.

The 'Theory' consists of two core principles, which (as revised in 2001) state that:

- a) Each person has the same indefeasible claim to a fully adequate scheme of equal basic liberties, which scheme is compatible with the same scheme of liberties for all; and
- b) Social and economic inequalities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity; and second, they are to be to the greatest benefit of the least-advantaged members of society (the difference principle).<sup>44</sup>

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<sup>39</sup> G A Cohen, 'On the Currency of Egalitarian Justice' (1989) 99(4) *Ethics* 906, 931.

<sup>40</sup> Hayek, above n 23.

<sup>41</sup> Okun, above n 1.

<sup>42</sup> John Rawls, *A Theory of Justice* (Harvard University Press, first published 1971, revised 1999 ed).

<sup>43</sup> John Rawls, *Justice as Fairness: A Restatement* (Harvard University Press, 2001).

<sup>44</sup> *Ibid* 42–3.

The ‘Theory’ has been praised as a holistic approach that is fundamentally different from the views circulating at the time — and criticised as setting up an unrealistic set of assumptions that cannot be replicated in an actual society under examination. It is based on what Rawls terms the ‘original position’, which establishes the parameters of the society. One of the criteria is that decisions are shrouded by the ‘veil of ignorance’, which assumes that the decision makers do not have any knowledge of the characteristics of the parties affected by the decision in order to ensure that the decisions made are not biased by the original structure.

The ‘original position’ assumes that all members of the society enter the social contract without any history — either of privilege or disadvantage. This is in order to ensure that the parties are negotiating as equals, not just in the contractual process but in the context of their position in society. Given that in a developed democracy Rawls’ requirements (a) and the first part of (b) are met, the next point of discussion is the application of the ‘difference principle’ which allows inequalities to exist where they are to the benefit of the least advantaged. In allowing some difference in favour of the least advantaged, Rawls lists what he classes as the primary goods needed to be a fully co-operating and equal member of society. The list includes the intangibles of basic rights and liberties; freedom of movement and occupation; powers and prerogatives of office; the social bases of self-respect and the more tangible element of income and wealth ‘generally needed to achieve a wide range of ends, whatever they may be’.<sup>45</sup> The issues surrounding the distribution of tangible assets of income and wealth are relevant to economists concerned with tax and transfer programs, while the intangible aspects are essential in the social contract framework, and may be used to justify programs such as affirmative action programs.

Although some commentators refer to this as the ‘maximin rule’, in the ‘Theory’ that terminology is reserved for the rule to be applied in cases of uncertainty. Where a redistribution of income or wealth is clearly to the benefit of the least advantaged, and is within the contract, the redistribution is to the benefit of society as a whole. However, in a pluralistic society there may be a number of alternatives. When choosing between alternatives the ‘maximin rule’ applies: consider the worst outcome under each alternative, and apply the alternative where the worst outcome is better than the alternatives. There are three preconditions that should exist for the maximin rule to be applied:

- a) In line with the veil of ignorance, there is no basis to estimate probabilities;

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<sup>45</sup> Ibid 58–9.



- b) As the decision makers are evaluating worst outcomes they must be able to guarantee that the worst outcome is satisfactory; and
- c) All other alternatives are unacceptable.<sup>46</sup>

### **Sen: the capabilities approach**

A different perspective on equality can be seen in the writings of Amartya Sen.<sup>47</sup> His writing is based on the capabilities approach, which would distribute resources to ensure that each individual has sufficient resources to function fully in society, based on their personal capabilities. He structured his 1992 work around the question ‘Equality of What?’ recognising that there are many aspects of a person’s life in which they may seek equality.<sup>48</sup>

Equality is judged by comparing some particular aspect of a person (such as income, or wealth, or happiness, or liberty, or opportunities, or rights, or need-fulfilments) with the same aspect of another person. Thus, the judgement and measurement of inequality is thoroughly dependant on the choice of the variable (income, wealth, happiness, etc) in terms of which comparisons are made.<sup>49</sup>

While economists are normally concerned with the variables of income and wealth, the appropriate allocation of other resources can be important in facilitating capabilities to achieve other basic human needs or entitlements. Thus this approach focuses on equality, with its broader meaning than equity.

The difference between this approach and that adopted by other writers lies firstly in the acknowledgement of diversity between individuals. It has been categorised as a pluralist approach in contrast to other approaches that focus on one moral value: such as utility or freedom. In that context, Sen’s approach could be seen to place more importance on horizontal equity than vertical equity: it acknowledges that access to equal resources will not of itself lead to equity between individuals. Sen has worked extensively in the field of developmental economics, which is reflected in his theory. Sen argues that individuals must have access to the appropriate set of resources to allow the individual to make appropriate choices from the range of options available.

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<sup>46</sup> Ibid 147.

<sup>47</sup> See notes 16, 18 and 36.

<sup>48</sup> See also M Walzer, *Spheres of Justice: A Defence of Pluralism and Equality* (Blackwell, 1983).

<sup>49</sup> Sen, above n 37, Chapter 1.

If we are interested in the freedom of choice, then we have to look at the choices that the person does in fact have, and we must not assume that the same results would be obtained by looking at the *resources* that he or she commands.<sup>50</sup>

Sen differentiates his approach from other writers as being concerned with the elements necessary to wellbeing, while other approaches are based on the instruments that provide the means to freedom. Libertarian approaches are also based on the individual rather than collective approaches, but the basis of libertarian philosophy is that the individual uses the market mechanism to acquire resources based on their own preferences. Sen argues that redistribution is necessary to ensure that a person has the resources required to maximise their capability.

He is critical of utilitarian welfare economics for not taking sufficient account of the diversity of individuals and their specific capabilities:

social welfare may be seen as a function of individual utilities, as in the welfarist framework of which utilitarianism is a distinguished case, involving ‘sum-ranking’ (i.e. simply adding up the utilities). Or alternatively, social welfare may be seen as a function *directly* of the vector of incomes (without being intermediated by the utilities related to those incomes), or of the combination of multiple-attribute characteristics of individual economic status or opulence.<sup>51</sup>

Poverty is seen as a problem of income inadequacy, rather than ‘lowness of income’: an individual needs sufficient income to convert it into the relevant capabilities. For example a person may spend more on food than their neighbour, but it still may be inadequate because, say, that person has specific nutritional requirements. This framework is applicable to the problem of poverty both in third world countries and in more affluent countries:

In explaining the apparent paradox [of food deprivation in rich America] the capability perspective can help in two different ways. First, hunger and undernutrition are related both to food intake and the ability to make nutritive use of that intake ... Second, being poor in a rich society itself is a capability handicap ... In a country that is generally rich,

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<sup>50</sup> Sen, above n 37, 38.

<sup>51</sup> Sen, above n 37, 94.

more income may be needed to buy enough commodities to achieve the *same social functioning*, such as ‘appearing in public without shame’.<sup>52</sup>

The capability approach is particularly well suited to addressing specific aspects of disadvantage, such as gender,<sup>53</sup> race or disability. By identifying what resources are required to ensure that a person can operate to their full capacity, that person can be assisted to make a full contribution to society.

### **Contrasting the theories**

During the late 20<sup>th</sup> century these noted economists and philosophers — Nozick, Harsanyi, Rawls, Sen and others — engaged in vigorous debate as to the merits of each other’s theories. Some of the conflicts between the approaches are irreconcilable, but ultimately, the differences in relation to the use of the tax transfer system lie largely in the balance between reliance on the market or the need for government intervention to redistribute income and wealth. However, it is instructive to review the criticisms that each has of the alternative theories.

Libertarianism is criticised on a number of grounds. First, are moral obligations adequately recognised within a framework of individual rights? For example, does a person interrupting a violent attack violate the rights of the attacker?<sup>54</sup> Further, Sen argues that liberal values inherently conflict with the Pareto principle because the liberal right to exercise free choice overrides the social decision function.<sup>55</sup>

Utilitarianism is also criticised for disregarding the position of individuals in favour of a measure of the welfare of society as a whole because sum total measurements disregard distributional shifts in the chosen criteria. Welfare indices are described as ‘measures of *distributional badness* ... of the particular configuration of personal incomes; they are not specifically measures of *inequality per se*’.<sup>56</sup> In contrast the capability approach is based on maximising the position of each person within a community, taking account of their capacity to utilise distributions. In this sense the capability approach is more concerned with the effect of resource distribution on the individual than on society as a whole.

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<sup>52</sup> Smith, above n 15, 111, 115.

<sup>53</sup> Martha Nussbaum, *Women and Human Development: The Capabilities Approach*, The Seeley Lectures (Cambridge University Press, 2000).

<sup>54</sup> Amartya Sen, *On Ethics and Economics*, The Royer Lectures (Basil Blackwell Ltd, 1987).

<sup>55</sup> Amartya Sen, ‘The Impossibility of a Paretian Liberal’ in *Choice, Welfare and Measurement* (Basil Blackwell Ltd, 1982).

<sup>56</sup> Sen, above n 37, 98.

One of the difficulties in making decisions between alternative social policies is that individuals may have different choices, and different outcomes may arise from those choices. Where the welfare of individuals has primacy, if the rights attached to the alternatives can co-exist no social choice needs to be made, and the decision can be left to the individuals. Any attempt to impose another outcome is an interference with individual liberties.<sup>57</sup> Alternatively, given that individual utility functions reflect the higher needs of the poor relative to the rich, the social welfare function already has priority over individual utilities, and is properly reflected in a linear social welfare function.<sup>58</sup> However, it is also argued that the social welfare function is not linear because it must reflect the different needs and capabilities of individuals. Where they are incompatible a third party will ultimately be called upon to make a decision,<sup>59</sup> resulting in an outcome similar to Arrow's Impossibility Theorem.

A further criticism of utilitarianism is the emphasis it places on rational behaviour. A rational individual will have two sets of preferences: personal preferences based on self-interest, and moral preferences based on perceptions of society. Utilitarian theory leads each individual to choose the better personal outcome, which also produces the best result for the society. Accordingly, Okun style trade-offs will arise, this time between moral and economic objectives:

anybody who wants to adopt a moral position more egalitarian than the utilitarian position already is, must admit that the well-being of the individual members of society is not his ultimate moral value, and that he *is* willing in certain circumstances to sacrifice humanitarian considerations to egalitarian objectives when there is a conflict between the two.<sup>60</sup>

However, this assumption of rationality is contested<sup>61</sup> because many decisions are made without access to full information, or in a state of mind where such information cannot be adequately processed.

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<sup>57</sup> Hayek, above n 23, 62–3.

<sup>58</sup> John C Harsanyi, 'Nonlinear Social Welfare Functions: Do Welfare Economists Have a Special Exemption from Bayesian Rationality' in *Essays on Ethics, Social Behaviour, and Scientific Explanation* (D Reidel Publishing Co, 1976) volume 12.

<sup>59</sup> Amartya Sen, *Collective Choice and Social Welfare* (Holden-Day, 1970).

<sup>60</sup> Harsanyi, above n 58, 48.

<sup>61</sup> Amartya Sen, 'Rationality and Social Choice' (1995) Mar 1995(85) *American Economic Review*; see also Nussbaum, above n 53.

Rawls' 'Theory'<sup>62</sup> generated much criticism when it was first published because a number of the views contained were considered to be radical: particularly in the use of the original position, the difference principle and the maximin rule. However, even critics of Rawls acknowledge his work as a watershed in modern philosophy, presenting as it does a coherent framework for justice.

The most common criticism of the 'original position' is that it is divorced from reality because it is not possible to ignore existing circumstances, such as existing rights.<sup>63</sup> However, this has similar outcomes to the utilitarian perspective, as expressed in the equiprobability model which states that if human beings share the same experiences, they will arrive at the same judgments.<sup>64</sup> If the parties to a moral contract do not have any previous experience to influence outcomes, they will see the outcome in the same way and the social decision function will lead to Pareto optimality. It is only when matters of inequality of experience or risk enter the decision process that individual preferences will emerge.<sup>65</sup>

However, it is the combination of the 'original position' with the maximin rule that is most problematic. When ranking decisions, the level of risk attached to a certain outcome will weight that decision — however the maximin rule does not allow any external considerations, such as risk, into the process. For example, in a case where a person is offered two jobs, one of which has higher rewards but also involves plane travel which has a low probability of the plane crashing causing catastrophic injury. While most people would consider the risk to be low enough to decide to take the high reward job, the maximin rule would prescribe the low risk, low reward job be chosen.<sup>66</sup>

The difference principle is framed in terms of groups within society, rather than individuals. The inclusion of this principle has been questioned on the grounds that under the 'Theory' all groups within society benefit from the agreement of social co-operation: this is the purpose of the negotiation from the original position. To specifically further benefit the least advantaged produces an asymmetrical result, leading to efficiency losses that are unacceptable to liberals.<sup>67</sup>

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<sup>62</sup> Rawls, above n 7.

<sup>63</sup> Hayek, above n 23, 89.

<sup>64</sup> Harsanyi, above n 33, 634.

<sup>65</sup> Ken Binmore, 'Social Contract I: Harsanyi and Rawls' (1989) 99 (Conference 1989) *Economic Journal* 84.

<sup>66</sup> John C Harsanyi, 'Can the Maximin Principle Serve as a Basis for Morality? A Critique of John Rawls's Theory' in *Essays on Ethics, Social Behaviour, and Scientific Explanation* (1976) volume 12, 39.

<sup>67</sup> Hayek, above n 23, 89.

Further, this ignores the benefit to society that may arise if additional resources are allocated to the purpose where they can do most good rather than to a particular person,<sup>68</sup> as advocated by libertarians.

Sen specifically contrasts his approach with the work of Rawls, characterising Rawls' work as focusing on equality of opportunity, particularly through his concentration on the distribution of primary goods. Although the maximin rule does not have regard for capabilities, it focuses on the least advantaged as a class, whereas the capability approach is more concerned with the capacity of the individual to fully utilise the opportunities made available, and Sen specifically distinguishes capability from primary goods and from achievements.<sup>69</sup> Rawls in turn responded that these primary goods are essential to develop capabilities, and are a part of the framework of the 'Theory'.<sup>70</sup>

Applying the merit principle to 'native endowments' is also contentious. While the 'Theory' regards such endowments bestowed on an individual as common assets that must be developed and enhanced through access to appropriate education before being used for the good of society,<sup>71</sup> the entitlement theory argues that such assets should be exploited by the individual in their self-interest, and that this of itself provides benefits to the society.<sup>72</sup> Alternatively, applying the capabilities approach ensures that a person has the best opportunity to develop those natural assets. A meritocracy that is truly based on abilities that the person has been able to develop fully will lead to the best utilisation of those assets for the society.

Alternatively, the 'luck egalitarian' approach argues that the distinction between choice and luck is not sufficiently recognised in Rawls' 'Theory'. While the influence of fortuitous factors is recognised, the difference principle as expressed does not take account of such factors, except to the extent that a person may benefit from the difference principle based on any resulting disadvantage. Where a person may choose to undertake a risky course of action, the moral question becomes whether they are entitled to be a beneficiary of the difference principle.

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<sup>68</sup> Sen, above n 59.

<sup>69</sup> Sen, above n 37, 81.

<sup>70</sup> John Rawls, 'The Concept of Justice in Political Economy' in Frank Hahn and Martin Hollis (eds), *Philosophy and Economic Theory* (Oxford University Press, 1979) 164, 168.

<sup>71</sup> Rawls, above n 7, 75.

<sup>72</sup> Hayek, above n 23, 123.

Cohen<sup>73</sup> argues that the difference principle allows incentives to encourage behaviour for the good of the community — but this can in effect perpetuate inequalities.

The difference principle can be used to justify paying incentives that induce inequalities only when the attitude of talented people runs counter to the spirit of the difference principle itself: they would not need special incentives if they were themselves unambivalently committed to the principle. Accordingly, they must be thought of as outside the community upholding the principle when it is used to justify incentive payments to them.<sup>74</sup>

Further, the social contract on which the ‘Theory’ is based assumes that people within a community have agreed to the ethos of that contract. The theory is based on just institutions that will ensure a just allocation of resources. To the extent that an individual chooses not to conform to that community, they are outside the social contract. Cohen argues that institutional justice and an egalitarian profile of rewards do not necessarily co-exist:

My own fundamental concern is neither the basic structure of society, in any sense, nor people’s individual choices, but the patterns of benefits and burdens in society: that is neither a structure in which choice occurs nor a set of choices, but the upshot of structure and choices alike ... A just society, here, is one whose citizens affirm and act upon the correct principles of justice, but justice in distribution, as here defined, consists in a certain egalitarian profile of rewards. It follows that a just distribution might obtain in a society that is not just.<sup>75</sup>

Reviewing the differences between the approaches, and the criticisms that emerge in the literature, it is clear that Nozick and Sen are more concerned about the consideration of individuals within the system — although Nozick is concerned with preserving entitlement, while Sen is concerned with distributing appropriately to those individuals to maximise capability. Utilitarians and Rawls apply their theories to society as a whole, through redistribution among the groups that make up society. Rawls, however, goes beyond the issues of financial resources to consider non-financial resources — as does Sen.

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<sup>73</sup> Gerald A Cohen, *Rescuing Justice and Equality* (Harvard University Press, 2008).

<sup>74</sup> *Ibid* 32.

<sup>75</sup> Cohen, above n 73, 126, 128.

## Current trends in inequality

In reviewing these theories of distributional justice, two striking features emerge. First, there was a period in the 1970s, prior to the political ascendancy of neoliberal economics, when this debate flourished: at the same time that the economists Anthony Atkinson, Joseph Stiglitz and others were developing measures of equity, the philosophers Robert Nozick, John Rawls, Amartya Sen, John Harsanyi and others were developing moral and ethical frameworks. Clearly the debate between these writers stimulated ideas and theorems based on their own economic philosophy, and expanding into areas of morality. For example, while there was much criticism of Rawls, there was also much respect expressed for the new framework that he presented.

It is worth noting that the increasing trends in inequality that have emerged during the dominance of neoliberal policies were observed by distributional justice theorists with concern before the impacts emerged so dramatically in 2008/09, with a number of important contributions to the literature being published in the last two years<sup>76</sup> while the global economy has been dealing with the effects of the market shifts.

Second, these philosophers continued to reflect on, develop and refine their philosophies throughout their careers. It is interesting to compare their early work with subsequent iterations: Rawls republished his theory in 2001,<sup>77</sup> the year before his death, addressing some of the concerns raised by other writers. Twenty-four years after the initial publication, Sen published an expanded edition of his work *On Economic Inequality* to address developments during that period,<sup>78</sup> and in his most recent book he has presented ‘a theory of justice in a very broad sense’.<sup>79</sup> While Nozick’s early work has been used here as an example of libertarianism, in his later writings he moved away from the position so clearly outlined in 1973.<sup>80</sup>

More recently the debate on equity has shifted to incorporate the third phase of Andersson’s typology,<sup>81</sup> discussion of the sustainability of resource allocation. It is becoming increasingly apparent that natural resources are limited, and that there is competition for the allocation of

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<sup>76</sup> See notes 18, 20 and 72; Michael Sandel, *Justice: What is the Right Thing to Do?* (Farrer, Strauss and Giroux, 2009).

<sup>77</sup> Rawls, above n 43.

<sup>78</sup> Amartya Sen, *Inequality Reexamined: Expanded Edition* (Oxford University Press, 1997).

<sup>79</sup> Sen, above n 18, ix.

<sup>80</sup> Simon A Hailwood, *Exploring Nozick Beyond Anarchy, State and Utopia*, Avebury Series in Philosophy (Avebury, 1996).

<sup>81</sup> Andersson, above n 5.



such resources. This is commonly discussed as an intergenerational or temporal issue because the impact of current practices will be felt by future generations. In accordance with their belief in a self-regulating market, neoliberals rely on price controls, growth and technology to address issues of scarcity.<sup>82</sup> Models are being developed to integrate sustainability into economics, from the well-known ‘triple bottom line’ reporting to more sophisticated 3-D models.<sup>83</sup> However, as long as economic, social and environmental policies are developed by national governments, based on national interests, global interests will come second — as seen in the current inability to reach agreement over the implementation of measures to counter global warming.

The most recent impacts have been felt though the globalisation of financial markets, rather than natural resources. Economic policy during the most recent economic expansion was dominated by free market theorists, who advocate that the market is most efficient when it is freed from restrictions. However, following the events of 2008/09, questions are being asked as to whether the free market philosophy encouraged financial practices that were fundamentally unsound.

In particular, there are questions as to the extent and distribution of inequality within society. In 2008 the OECD study of the extent of inequality within OECD countries found that:

Overall, over the entire period from the mid-1980s to the mid 2000s the dominant pattern is one of a fairly widespread increase in inequality (in two thirds of all countries) ... Across the 24 OECD countries for which data are available the cumulative increase is of around 0.02, i.e. about 7%, with most of the rise experienced in the first decade ...<sup>84</sup>

While this calculation is based on the Gini coefficient, an empirical measure of the welfare of society as a whole, it is also clear that measures which compare the relative position of the lowest income earners with the highest show a more dramatic increase than the Gini coefficient, with the OECD report concluding that the widening of inequality over the past 20 years is ‘moderate but significant’.<sup>85</sup> Data on the share of total pre-tax income earned by the top

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<sup>82</sup> William E Rees, ‘An Ecological Economics Perspective on Sustainability and Prospects for Ending Poverty’ (2002) 24(1) *Population & Environment* 15.

<sup>83</sup> Volker Mauerhofer, ‘3-D Sustainability: An Approach for Priority Setting in Situation of Conflicting Interests Towards a Sustainable Development’ (2008) 64(3) *Ecological Economics* 496.

<sup>84</sup> OECD, above n 3, 28.

<sup>85</sup> *Ibid.*

1% of income earners shows a significant upswing from the mid-1980s to 2000 so that in most jurisdictions the share of income earned by the top 1% of income earners is now comparable to the levels that existed before 1940.<sup>86</sup>

An examination of trends in the tax systems of OECD countries since the 1980s clearly shows the influence of the neoliberal market based doctrine, particularly in liberal democracies. The overall ratio of tax to GDP has not changed dramatically, but the mix of taxes and the basis of transfer payments has. The trends identified show:<sup>87</sup>

- decreases in top marginal personal income tax rates and a consequent reduction in the progressivity of the personal income tax system;
- decreases in corporate tax rates coupled with systems to reduce the tax on corporate distributions;
- increases in broad based consumption taxes compared to other forms of consumption taxes and increases in social security taxes; and
- the design of transfer payments has tended to focus more on targeting payments to those in need, specifically those in poverty or the aged and imposing obligations on recipients.<sup>88</sup>

This data could be interpreted to demonstrate two of the issues raised earlier:

1. Neoliberal policies that rely on market growth to produce equity result in gains to those who already have property or income, who are generally in the high income deciles; and
2. Utilitarian welfare measures such as the Gini coefficient reflect the overall distribution of income and wealth within a society, but further analysis is necessary to identify shifts between groups within the society.

A detailed empirical analysis of these trends relative to prevailing economic advice from time to time would be an interesting further examination.

What appears to be happening is that certain groups within society are benefitting under current policies. In the liberal democracies of New Zealand, UK, USA and Canada the gains appear to be among high and low income earning groups, possibly as a result of tax policy reducing the

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<sup>86</sup> OECD, above n 3, 32.

<sup>87</sup> Åsa Johansson et al, 'Tax and Economic Growth' (OECD Economics Department Working paper No 620, OECD, 2008).

<sup>88</sup> OECD, above n 3.

taxes paid by the rich and poverty alleviation policies that assist the poor. There is also evidence that the elderly are more likely to suffer poverty than younger people.<sup>89</sup> The tax and transfer policies of a government will have significant impacts on inequality: for example the extent of progressivity in the system, taxation of capital compared to the taxation of income from labour, and the redistribution of taxes (often through direct transfer payments) to target pockets of disadvantage will all impact on the extent of inequality and the relative positions of the highest and lowest income earners in society.

An examination of economic cycles of developed economies over the 20<sup>th</sup> century shows the effect that the adoption of different economic policies has had on distributional equity. While specific policies in the English-speaking liberal welfare states<sup>90</sup> differ, they tend to show similar trends in tax and transfer policies and in economic cycles.<sup>91</sup> The early part of the 20<sup>th</sup> century featured laissez faire market based policies which were moderated after the two world wars and the intervening recession to adopt welfare policies that allowed government intervention to correct market failure and facilitate redistribution of resources. Welfare economics grew out of this period. However, the latter decades of the 20<sup>th</sup> century saw a resurgence in neoliberal philosophies in order to curb government spending and shift economic activity back to the free market.

In the same ways that economies experience cycles of expansion and contraction, governments will also change their economic policies to comply with prevailing economic theories — and these changes cannot always be explained by the popular perception of whether the elected government is conservative or liberal: governments of the expansionary post-war years applied different policies to those of the 1970s and 1990s, irrespective of the political party that was in power.

In the current economic climate there is more attention on apparent inequalities in society: the excessive pay packets received by executives who are seeking government support to prop up ailing industries, compared to the loss of jobs among casual and part-time workers. For example in the UK, in response to the economic crisis, the 2009 Budget announced changes to increase taxes and reduce benefits to high income earners. While these moves have been

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<sup>89</sup> OECD, above n 3.

<sup>90</sup> Gosta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Polity Press, 1990). Generally speaking the English-speaking countries of Australia, Canada, UK and USA are categorised as liberal welfare states.

<sup>91</sup> Neil Brooks, 'Taxing the Wealthy' (Paper presented at the Conference Australia's Future Tax System: A Post-Henry Review, Sydney, 21–22 June 2010).

criticised and it has been predicted that they will result in tax avoidance as people try to remain below the new 50% tax threshold, the proposal is clearly capitalising on the general belief that the ‘super-rich’ are not paying their share of taxes.

The OECD study<sup>92</sup> identifies the extent to which the tax transfer system has been used in different jurisdictions, and the impact it has had on the growth in inequality: generally it dampened inequality between 1985 and 1995, but as benefits became less targeted on the poor between 1995 and 2005, inequality increased. The increasing inequality of market income can be significantly ameliorated by the redistributive effect of the tax transfer system, if it is appropriately targeted.<sup>93</sup>

## **Conclusion**

Two of the major functions of tax transfer systems are to fund the direct expenditure of government, and to redistribute resources. Public policy in both of these areas will be influenced by the underlying philosophical perspective of policymakers. The trade-offs needed between efficiency and equity require public policymakers to strike a balance between free market, interventionist and redistributive policies — the current global financial crisis is attributed by many commentators to the lack of regulation in many industrialised countries that have adopted neoliberal free market based policies in relation to the financial sector.

However the purpose of this article is not to examine these trends empirically, but to review the literature on distributional justice, to identify the major theories; to identify the moral and ethical underpinnings and the role of redistribution within these theories. This analysis focused on the work of a number of philosophers and economists representing the major schools of economic thought.

The trend toward greater inequity in OECD countries has occurred over the past two decades, during which the predominant economic philosophy has been neoliberalism under which market forces are allowed to dominate. To the extent that the market is seen as efficient, this trend has been accepted as increasing productivity, which allows the creation of jobs and wealth throughout the whole of society. If this widens the gap by creating greater benefits for those with more wealth, then that is an acceptable outcome. Utilitarians would also respond that

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<sup>92</sup> OECD, above n 3.

<sup>93</sup> OECD, above n 3, Figure 11.6, 293.

the overall increase in the wealth of society is an acceptable outcome: however, they would apply redistributive strategies to ensure that deserving groups within society are protected. Within the market philosophies adopted by the UK and Australia over the past two decades, there have also been tax transfer measures that have targeted families with children to maintain their welfare. This would also accord with Rawls' 'difference principle', which states that where there are inequalities they should be in favour of the least well-off. However, there are other groups in society that have fallen further behind, such as the single unemployed. The capability principle advocated by Sen would suggest that policies be targeted to identify why such groups are disadvantaged, and attempt to address that disadvantage; as recently endorsed by Dr Ken Henry<sup>94</sup> in the context of the Australian tax transfer system.

While philosophers and economists have distilled the essential elements, views range across a broad spectrum. Ultimately there is no easy answer to what is fair because it depends on the moral and ethical underpinnings of the person making the decision or designing the policy, and how they see the relationship between the individual and society. Public policy may incorporate elements of all of the philosophies I have discussed: the issue then becomes one of the extent of the trade-offs that are acceptable.

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<sup>94</sup> Ken Henry, 'How Much Inequity Should We Allow?' (Paper presented at the Australian Council of Social Service National Conference, 3 April 2009), <<http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/speeches/05.htm>>.