INCOME AS A MEASURE OF WELFARE: THE ISSUES AND A DISSENT

Wm. C. Birdsall, Social Security Administration

When I finished my homework on the topic of income as a measure of welfare, I saw my task as a relatively simple one: itemizing and organizing the technical problems which everyone runs into in building up from income to something like welfare, problems such as price indices and non-market consumption; how to include assets, leisure, and public services in the index; how to take into consideration need, uncertainty, and future expectations. As I proceeded through these problems, I found it impossible to confine my thoughts to those technical questions. The conviction grew in my mind that the important issue is what is this all about: Is the problem essentially a scientific one, similar to comparing temperatures? Is the problem one of discovering the actual norms used by society and government? Or is the problem one of social reform? That is, is it describing the world in such a way as to convince the government or the populace that it ought to be changed, either in general or along particular lines? I think that the basic question is social reform.

As a framework for explaining why I arrived at that conclusion and what it leads me to, I will briefly review some of the technical issues in the economist's progress toward a measure of welfare. My device is to set up a dialogue between two economists who share the conviction that a measure should and can be found. The dialogue I describe is apt to arise in the context of attempting to decide on the appropriate base for taxation on the assumption that somehow welfare of "well-offness" should be the norm. The catalogue of issues is not meant to be exhaustive, but I hope it is representative. The practical solutions that I mention are not universally accepted, but they are at least typical of actual solutions. One economist is a practical man, trying to get the job done. The other is a stickler or a devil's advocate. For my purpose it will be sufficient to limit the dialogue to the question of "equal treatment of equals", or horizontal equity. Extra problems arise in putting families or individuals on some scale to quantify inequality in order to reach the goal of a measure for vertical equity. The dialogue opens:

Pragmatist(tentively): Annual money income seems a reasonable norm for equal treatment.

Stickler: If two people are subject to different sets of prices, they cannot both buy the same set of goods if they have equal money incomes. Furthermore, by a theorem of Samuelson [2], in this circumstance there is no price index which will tell us unambiguously who is better off, even if both people have identical needs and tastes.

Pragmatist: I grant the point. But we must get some measure; let's either accept money income or estimate real income by some agreed upon price index and get on with it.

Stickler: How about such things as home grown food and owner-occupied housing, shouldn't they somehow be included?

Pragmatist (condescendingly): Using known market prices we will impute the value of these types of consumption and add that to income.

Stickler (slyly): How about the fact that some sets of people, such as families, pool their incomes?

Pragmatist: We will simply use these groups as our basic units.

Stickler (pouncing): Then how about the fact that families differ in size, age composition, etc. and thus differ in need?

Pragmatist (triumphantly): I have two possible solutions: We scientifically determine need via diets and build up to needed income from these; thus two families with equal real income are only to be treated as equals if they have equal need; or alternatively we assume that two families that spend the same percentage of their income on, say, food are equals, independent of what their real income is.

[The Stickler has problems with the scientific character of estimates of nutritional needs and he knows that the second solution assumes any differences in consumption tastes between families is due solely to the number of persons in the family; but he lets it go since he has no alternative solution.]

Stickler: Earlier you were happy to impute consumption of home-grown food and housing to income. How about leisure: what if one man earns twice as much per hour and only works half as many hours, loafing the rest of the time; isn't he better off even though both have the same income?

Pragmatist: Based on utility maximization theory we know that leisure is a good valued by each at his or her marginal wage rate; thus I advocate adding the product of leisure hours times the wage rate to income.

[The Stickler knows that this solution assumes that individuals are free to adjust hours worked as they please. He sees a dilemma: at best the criterion must discriminate either against families who work more hours or against families involuntarily working fewer hours. But again, he has no better solution.]

Stickler (tiring): How about assets and wealth and the fact that they vary by family, shouldn't that be somehow incorporated? In fact, shouldn't our norm for equal treatment take into consideration the welfare potentiality of the family over a much longer span than just a year?

Pragmatist: I agree that in theory we should be looking for a lifetime norm. Practically we must settle for the following: we have techniques based on life expectancies, rates of return, etc. of translating these stocks of assets into a constant annual flow. We just add that to income.

Stickler: How about public housing? Shouldn't that subsidy be added to income?

Pragmatist: Yes, by the same logic as owner-occupied housing.

Stickler (somewhat exhaustedly): How about local public services and the environment? Certainly, you won't consider two families equal that had the same income and paid the same amount in taxes if they differed by the amount of smog or public safety each consumed?

Pragmatist (defensively): I agree with you, but we just haven't yet come up with reasonable coefficients to translate these differences into money terms to add them to or subtract them from income.

[The Stickler is disappointed that science is finally defeated in its quest and he is silent, not raising the additional problem of the uncertainty about income and/or the variability of income, the possible interdependence of welfare beyond the basic family, and so forth.]

CURTAIN

In the light of all these problems and solutions, I ask the question, "What is this all about?" "What are we really trying to do or where are we trying to get?"

One possible answer is that we are trying to measure actual relative well-offness, that is, to find an indicator which will truly tell us when two persons or families are equally well off, like a thermometer will tell us when two persons have the same temperature. I, and I think virtually all economists, admit that this is not what is really being done. We are too aware that welfare depends on many more things than we even dream of taking into consideration.

Is the goal to find the actual norms which society or government uses for equality and inequality of "treatment"? Certainly not; to do this we would simply look to our laws to find the actual norms used. For direct norms we would examine such laws as our tax and welfare provisions; for the indirect norms we would examine the rest of our legislation, and find such norms as acres of cotton planted--and acres of cotton not planted. Important as this task is, it is not what the dialogue is all about.

We are certainly somehow in the realm of ethics, a rule for equality of treatment is the goal. And we seem to be in that realm in a very practical sense, in the social reform sense that we are proposing a norm by which to develop social policy.

If we grant that the essential forum of the dialogue is social reform, what society ought to do, it will probably amaze anyone but an economist that there is little overt ethical discussion in the dialogue. We do not hear the pragmatist say that public housing tenants should be taxed more or given less or that leisure should be taxed.

I think that the reason why the dialogue takes place in something of an ethical no man's land is that the actual course of the discussion is determined by economists' natural desire to take into consideration the actual or potential consumption of all goods; that is, to deal with the general constraint on consumption. Because of the presumed need for a one dimensional measure of equality and inequality, he simply translates this constraint on consumption into a single dimension. To him this is a technical task and his rules do not need examination, except by the science of economics.

I take strong issue with this. My starting point is the earlier-mentioned theorem by Samuelson. It says essentially that even linear constraints are only comparable if the slopes in every dimension are identical. This theorem applies not only to the initial question of the price index; it applies at each decision in the dialogue. Another way of stating the theorem is this: if one insists on translating contraints into a single dimension all important differences between contraints must be reconciled by scientifically arbitrary decisions. At each step in construction unless we agree with what is an essentially ethical decision we must conclude that the index is simply a "compounding of arbitraries" which is certainly itself arbitrary. Thus we must examine the rule or goal governing the pragmatist's decisions.

Especially since the pragmatist tries to translate everything into dollars, his goal may seem to be to find the point at which the family's constraint cuts the money income axis, the point we can call maximum potential money income. Attaining this goal is a near impossibility. We seldom have any data about the shape of the constraint in the vicinity of any axis and especially near the point of maximum potential money income. For example, what on earth is the marginal wage rate at maximum work hours, where "maximum" here means at the limit of one's physical capability? Certainly the pragmatist is not striving for this goal since he evaluates leisure at the actual wage.

I think that two norms govern most of his decisions; one is applied when differences in the constraints faced by various groups arise due to differences in how government already treats people; the other is used for differences due to (apparently free) consumer choice.

Decisions made in the face of present differences in treatment by government seem to be based on the assumption that where treatments differ, cost differences are equivalent to income differences. Except in the case of money transfers this is doubtful. Take public housing for example. To attribute the subsidy to the dweller is to assume a remarkable efficiency on the part of the housing authority, and it assumes that public and non-public housing is otherwise identical. Unless there is a long waiting line for public housing and a low vacancy rate it is difficult to argue that any net subsidy is received by the tenants. Thus this rule seems very arbitrary to me.

The pragmatist decisions in confronting differences due to apparently free consumer choice, such as in the leisure/work hours question, seem to be made in accordance with the goal of making the index neutral with respect to that choice, at least in the vicinity of present equilibrium. That is, if the index were used as a tax base, its existence would not affect your marginal choice between leisure and work. While there are ceteris paribus arguments for neutrality in government treatment rules, I think that the ceteris are seldom paribus. That is, none of us is really indifferent about all the marginal choices made by others, both because we judge various choices as good or bad for the chooser and his or her family and because choices will affect costs, both dollar costs of programs and externality costs. Neutrality should be put in its proper perspective, not as a norm given by God or Moses to be followed in all circumstances, but as a good characteristic of a policy if it is feasible and if society does not care about individual choices in that area.

In summary, I judge any welfare index, the translation of the complexities of the consumption constraint into a single index, as arbitrary; I see such indices as based on questionable assumptions and inadequate acknowledgement or examination of the hard ethical decisions which must be made in building a treatment norm, and more importantly, that must be made in determining good social policy in general.

In rushing to an index I think we rush right by what is most effective for social reform, data about the concrete consumptions constraints that families, especially poor families face. That data, not an index, is the most useful thing for determining the need for social reform, for convincing others of its need, and for discovering solutions. (I do not mean to overstate the givenness of data or the availability of important data. I would, in fact, emphasize the money, the time, and the inventiveness needed to develop good data and to squeeze the meaning out of data.) Especially if our impetus is toward social reform, we should not underestimate the ability of facts to change opinions and to change preferences about social policy based on erroneous opinions. I wish we had a national opinion poll from 1965 to tell us who were thought to be poor by age, sex, race, and working status to compare with the data in "Counting the Poor [1]". Gathering more and better data on income by sources and analyzing it better have been the breakthroughs of the late sixties. I hope that doing the same for consumption of market and non-market goods will be the breakthrough of the seventies. Besides the problems our pragmatist had to deal with, I would include mental illness, disease, malnutrition, and crime as topics of such consumption studies.

While gathering and analyzing the facts are, in my opinion, the most important contributions economists can make to social reform, our contribution must not end there. The task of trying to predict the direct and indirect cost of alternative policies is certainly next in priority. If errors about characteristics of the poor stymied reform in the 60's, our fears about the direct costs of ameliorative policies and about indirect costs due to the recipients' and taxpayers' reactions to these policies may stymie reform in the 70's. Unfortunately, excuses may be able to stay ahead of refutations, but excuses unrefuted never seem to die.

REFERENCES

1. Orshansky, Mollie, "Counting the Poor: Another Look at the Poverty Profile", Social Security Bulletin, January, 1965 (28, No. 1), 3-27.

2. Samuelson, Paul, "Evaluation of Real National Income", Oxford Economic Papers (New Series), Vol. II, No. 1, 1-29.