

Fact and Value in Public Policy: Three Examples

I THE EQUALITY-EFFICIENCY TRADE-OFF

One widely discussed conflict of values, in addition to uncertain positive relationships, is a conflict between equality and productive efficiency, which is what the late Arthur Okun called ‘the big trade-off’.¹ In the interests of exposition, I shall defer to [Chapters 15](#) and [16](#) some of the problems associated with the concept of ‘equality’. Here, I shall ignore the question of the criteria by which any particular distribution is to be regarded as ‘valuable’, or whether equality has intrinsic value or solely instrumental value – for example, is consistent with some concept of ‘justice’ or is conducive to greater social harmony. And I shall follow the convention in welfare economics of focusing on the distribution of *income* and whether that conflicts with productive efficiency and hence with prosperity.

Of course, some policy measures designed to improve income equality – such as elimination of job discrimination on grounds of race, religion, colour or gender – will tend to improve economic efficiency rather than reduce it. But it is often assumed that there is a conflict between equality and efficiency because some policies designed to increase equality are quite likely to reduce productive efficiency. An obvious example would be redistributive taxes and benefits. It is possible that higher income taxes and benefits would distort people’s choices in a way that reduces output below the socially optimal level. For they would drive a wedge between people’s willingness to work

and the marginal social value of their work. Given the enormous variety of tax and benefit regimes that can be adopted, their possible indirect ramifications are so great that one cannot be certain either about the economic impact or about the precise effect on the equality of income distribution. But it is possible to give some sense of the difficulties involved by considering one specific redistributive economic policy instrument, namely the imposition of minimum wages.

Minimum wage legislation of one kind or another has been widely advocated and implemented on egalitarian grounds. It has even been adopted in such a market-oriented economy as the USA. It does not usually discriminate between poor regions of a country where there may be large pools of workers willing to work for very low wages rather than not work at all, and rich regions where there may be few such workers and where, anyway, many of them may be members of more affluent families. Economic theory would suggest that, compared to, say, family income support, this might be a clumsy and inefficient method of achieving some ethical objectives concerning the welfare of poor people.

But it is a good example of the possible mixture of positive economics and value judgements that may be used to justify the policy, and the manner in which the relevant value judgements may depend on which particular positive propositions are accepted. For example, suppose the proposal is defended by appeal to the positive proposition that the policy would force firms to be more productive and would drive out inefficient firms. There is some evidence (mainly from Scandinavian countries) that although the higher wages for otherwise low-paid workers may mean that some of them will be laid off, it also seems to force inefficient companies out of business. Hence, as long as macro-economic policies maintain a given level of employment, there may be an increase in the 'efficiency' with which resources, including labour, are being used. In other words, greater wage equality could lead to 'creative destruction' of less efficient companies and leave room for the displaced workers to be absorbed, in the end, in more progressive companies.² But, we might follow Hume's example and ask 'So what? What is so good about the increase in productive efficiency?' An advocate of the policy would then presumably argue that (i) greater productive efficiency would lead to greater prosperity and (ii) greater prosperity is a top-level intrinsic value.

But suppose the implied positive proposition that the policy would increase overall productivity is challenged? After all, the basic textbook theory of how a *competitive* labour market works suggests that there would

be some rise in unemployment among some unskilled workers who could no longer find a job at the new minimum wage who would have been quite willing to work at a lower wage. It is true that there is not much factual support for this view, and some evidence suggests that in Britain there was no significant loss of employment as a result of the introduction of, or increase, in the minimum wage, except perhaps following large increases in the minimum wage in 2001 and 2003.³ But, for the sake of the argument, let us assume that the rise in (or introduction of) minimum wages does lead to some unemployment and hence some loss of overall prosperity.

This does not, however, mean that the policy should be abandoned. For it could still be defended on the grounds that it would lead to some overall rise in the equality of wage distribution. But we might well ask ‘What is so good about that?’, to which many people would answer that it is instrumentally valuable since it will lead to greater equality of some higher level intrinsic value, such as greater equality of income distribution among households. This, in turn, might be challenged and might be defended on the grounds that either it is intrinsically valuable in itself, or that it is instrumentally valuable in so far as it promotes some higher-level intrinsic value, such as equality of welfare. Indeed, in popular political debate this defence of the policy has more support than the productivity motivation.

But even if this value judgement is accepted we are still not out of the woods. For if the policy leads to a rise in some wages but also leads to some unemployment, how does one trade-off the rise in wages of some against the loss of income of others? If one is concerned with some overall level of measured equality of low incomes the net effect may be indeterminate. Of course, it is possible that such a policy is not supported out of a concern with ‘equality’ in general, but out of concern with other value judgements. These might include, notably, a focus on the position of the worst off in society, along the lines of ‘prioritarianism’ discussed in more detail in [Chapters 15](#) and [16](#).

Another value judgement that will often motivate support for minimum wage legislation would be the elimination of what one might regard as ‘exploitation’. This might provide a justification for minimum wage legislation even if it can be demonstrated that there are better ways of keeping people out of poverty, such as family income support. And some people may support the policy on account of one sort of egalitarianism or another even if it is likely to lead to a loss of productive efficiency and

hence prosperity. There cannot be any precise method of weighing up these two conflicting values.

And there is yet another important value that could be brought into the argument. Some ‘Libertarians’ might object that minimum wage legislation infringes people’s right to enter freely into contracts, including contracts concerning the supply of one’s own labour. (But how many libertarians would support the right to sell oneself into slavery?)

In short, one is faced with scope for both major differences of opinion concerning the facts of the case and major differences of opinion as to the relevant value judgements. And which facts are relevant depends on what one believes to be the relevant values, and vice versa. An egalitarian would be more interested in the likely effect on overall equality than a prioritarian, who would be more interested in the likely effect on the worst off. If one is a libertarian, what matters is the degree of restraint on the free choices of the workers and the employers. Conversely, if the facts are that the policy would lead to a significant rise in unemployment, what matters is the trade-off of the ‘prosperity’ value against any egalitarian value – that is, Okun’s ‘great trade-off’.

In the latter case the optimum policy will then depend on how far we believe that the greater equality will cause less prosperity and the relative strength of our attachment to these two competing values. For example, consider [Fig. 6.1](#) in which we show the indifference curves I_0 and I_1 relating equality to efficiency for Mrs Brown and Mrs Jones. The curves are convex, like ordinary indifference curves, and so show that the greater is the level of equality the more equality one is prepared to sacrifice in order to achieve a given increase in output, and, conversely, the greater is output the more output one is prepared to sacrifice for a given increase in equality. Assume that the two characters are equally egalitarian in the sense that they both attach the same value to equality, so that they have the same indifference curves relating equality to efficiency.

[Figure 6.1](#) also shows two lines, B and J, representing each person’s assumption as to the trade-off between equality and efficiency. These represent their assumptions about the positive characteristics of the economy. They are not differences in the relative values they attach to equality, like the indifference curves described earlier. They correspond to the budget lines in ordinary consumer demand theory. Line B represents Mrs Brown’s belief, namely that there is a strong conflict

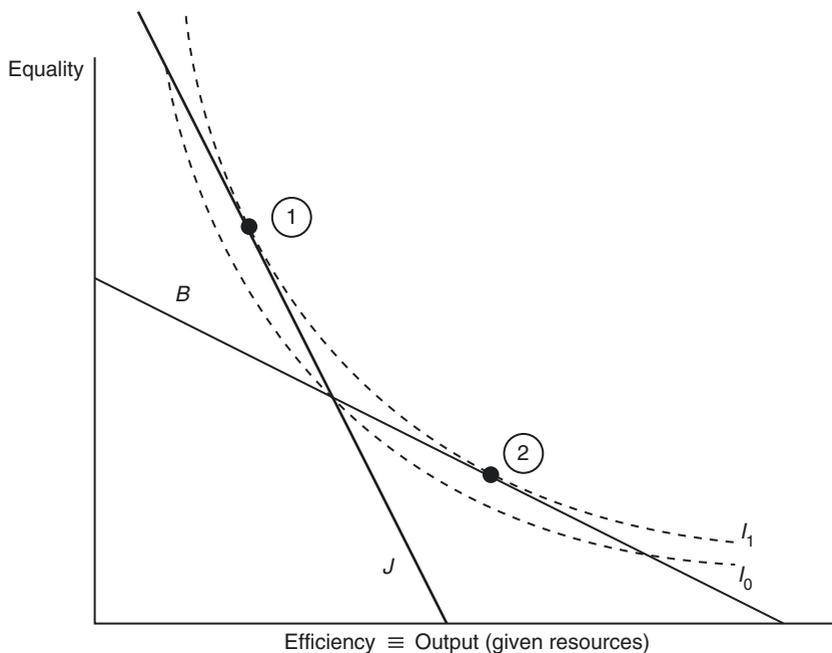


Fig. 6.1 The equality–efficiency trade-off: fact or value?

between efficiency and equality. In other words, she believes that a very great sacrifice of output is required in order to achieve a very small increase in equality. Line *J* represents Mrs Jones's beliefs that very little sacrifice of output will suffice in order to achieve a very great increase in equality. Consequently, Mrs Jones will prefer a situation that corresponds to more equality and less output than would Mrs Brown. But that is because they have different views as to the positive relationship between equality and efficiency. Their preferred optimum points may seem to indicate that Mrs Jones, at 1, is more egalitarian than Mrs Brown, at 2, when, in fact, this is not the case at all. They just have different views on the degree of conflict between the two objectives, which is a matter of positive economics. It would also be quite possible for both parties to agree on the actual degree of conflict but disagree on the value they attach to the competing objectives. In that case they would have different indifference curves and would finish up at different optimum

points that would correctly indicate their different degrees of egalitarianism. Thus we have again an example of the inextricable mix of fact and value in defining an ‘optimal’ choice.

2 THE PRICE STABILITY OBJECTIVE

Another conflict of policy objectives that is frequently in the news is the conflict between price stability and full employment. Several years ago Martin Wolf published an article in the *Financial Times* headed ‘The Fed must weigh inflation against the risk of recession’.⁴ He was referring to the difficult choice that the US Central Bank (the Federal Reserve Board) had to make in 2008 between raising interest rates to check the threat of inflation or reducing them to check the threat of a recession. A few months later, in the same newspaper, a column was headed by the announcement that the Governor of the Bank of England ‘backs job losses to curb inflation’.

In fact, the conflict between full employment and stable prices has been one of the most perpetual conflicts in economic policy for decades. But is there, in fact, a trade-off between stable prices and full employment, and, if there is, exactly how big is it? This positive relationship has been the subject of an enormous amount of empirical investigation. And why are people so concerned with these two objectives?

The case for full employment is easy to see. High unemployment means an unnecessary loss of output (i.e. a loss of economic efficiency) and hence conflicts with what many people would regard as a basic value, namely the material well-being that enters into ‘prudential values’. More importantly, perhaps, it also causes a direct loss of welfare associated with the psychological distress that unemployment – or the fear of it – usually creates.

But how strong is the normative proposition that governments ought to preserve price stability? Few people would regard price stability, *per se*, as a top-level ethical value. A taste for some particular numerical value – namely zero – for one particular statistic, namely the change in the price index, would constitute a strange form of number fetishism. Nevertheless, the aforementioned quotations represent a genuine concern among the public and the authorities. So one has to go back a bit and look for positive relationships between price stability and some other values with which one can more easily sympathise. Links between inflation and more understandable higher-level objectives include the following:

- (i) It is believed that inflation causes economic inefficiency in various ways. For inflation might create a more unstable economic environment that could lead to lower investment and hence slower economic growth, and hence less longer-run prosperity. Inflation might also make entrepreneurs devote more attention to speculative factors – such as which of their raw material prices will rise most – than to productive innovations and efficiency. If one asks ‘what is so good about greater economic efficiency and its accompanying prosperity?’ the answer might be that this will lead, via, say, more expenditure on health, education and personal ‘prudential’ values, to increased happiness, and this, in the end, is a basic value. Such a sequence is shown in Fig. 6.2. In addition, people may lose welfare on account of having to make more frequent trips to the bank to draw out the minimum cash to satisfy immediate needs (which is why this particular loss of welfare is known in the jargon as ‘shoe leather costs’). Both these – and other – effects of inflation are thus linked, by positive economic assumptions, to more prosperity which could be regarded as being either a basic value *per se*, or one that is instrumental in leading to a unique basic value of ‘happiness’.
- (ii) Inflation is also often believed to increase inequality of income distribution. It is easier for the rich to protect themselves against inflation. For example, they will be able to afford financial advisers, they may be able to spread their assets, they can hold some equities, or gold, or jewellery, or medieval suits of armour, and so on. The poor cannot do these things and wouldn’t have anywhere to put the suits of armour anyway. So inflation could increase inequality, which would conflict with a very widely held basic ethical value. Inflation is also likely to affect the distribution of real income between age groups. For it is likely to harm those pensioners whose pensions may not be adequately indexed and benefit younger age groups since the real value of their mortgage liabilities is likely to fall.

Thus the conflict between full employment and price stability seems to boil down to a conflict between, on the one hand, unemployment that reduces happiness both directly and indirectly (via a loss of output), and, on the other hand, the adverse effects of inflation on equality and happiness, either directly or indirectly. Thus an optimal policy would depend partly on the validity of the presumed positive steps in the argument – such as the effect of inflation on equality – and partly on the relative strength of

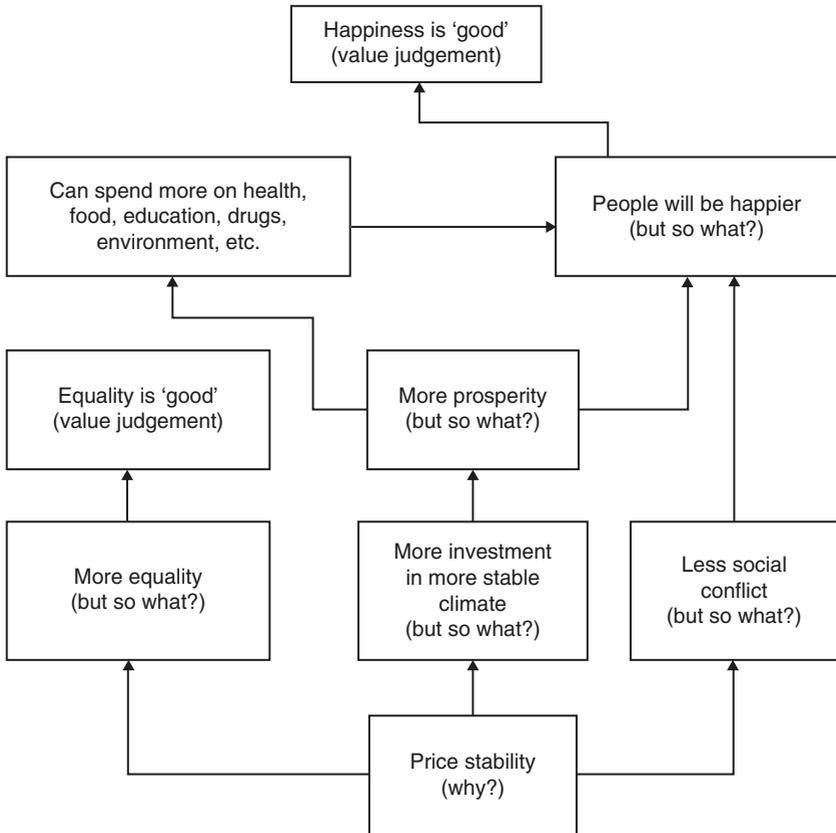


Fig. 6.2 A choice of paths to the ultimate policy goal

the basic values of equality and personal happiness and prosperity. So suppose, for the sake of argument, that some convincing empirical studies are found that show that, in fact, inflation does not make the distribution of income more unequal.

After all, as Sir John Hicks pointed out many decades ago, the operation of the tax system may often mean that profits are hit more than wages at times of inflation. Furthermore, if the inflation is thought to originate from 'wage-push' then, in an internationally competitive environment or in conditions of strict monetary constraint, it may not be possible for firms to pass on the wage

increases in prices, so that profit margins will be reduced and there will be a fall in the share of profits in national income. If, then, for one reason or another, some people who had previously been against inflation only because they had believed that inflation added to inequality now discover that, in fact, it did not do so, their opposition to inflation might disappear.

3 THE 'FAIR TRADE' PROBLEM

Another illustration of the inextricable link between ethics and economics and of the influence of the facts on value judgements is the widespread opposition to imports of manufactured goods produced with the aid of child labour. If the contracting partners enter into the trade freely it will often be assumed that both parties benefit. It is true that – for reasons discussed in [Chapter 8](#) concerning the well-known 'Summers memorandum' – this does not mean that *all* the parties involved, including the children and their parents, must benefit from the trade. But suppose that they do. Many people will still oppose the trade on what they believe are 'ethical grounds', such as that we should not profit by the 'exploitation of child labour' (though the opposition will often really be motivated by disguised protectionism). But if the children and their parents do benefit from the trade what is the ethical basis for restricting the imports in question? Suppose the facts are that restricting the trade will not only further impoverish the families in question but also lead to the employment of the children in agriculture under even harsher and less profitable conditions? In that case the optimal ethical policy might be to take steps – such as subsidising child education in the countries in question – that will reduce the pressure on people to put their children to work in manufacturing, rather than erect barriers to the imports in question.

4 CONCLUSIONS

One could go on and on showing how both value judgements and positive propositions must enter, sooner or later, into any specific normative economics prescription. But, hopefully, a few key points have emerged from the previous discussion.

First, however compelling the ethical appeal of certain normative propositions as economic policy is concerned, they will invariably still depend on positive economics.

Second, nevertheless, whatever sequence of arguments is used to justify any normative proposition, at some stage one is driven to introduce some

basic value judgement. This is not always a simple matter since different routes that follow different sequences of positive propositions may lead to different value judgements.

Third, even when we have arrived at the relevant value judgement, this is not necessarily the end of the argument, since value judgements are not beyond dispute, even though they are not amenable to ‘reasoned’ debate in the way described by Hume. For most people have plural values, and some policy problems may require resolving a conflict between incommensurate values.

Thus ethical issues lie at the heart of normative economics. In most cases – such as those entering into the topical economic policy issues discussed above – it may be easy to spot them. But in some policy issues the relevant value judgements are less obvious, and that may impinge on important topical issues, such as the export of polluting activities, environmental protection and distributional policy. If the value judgements relevant to any policy problem are not adequately appreciated some of the valuable achievements of welfare economics can be put to the wrong use. The function of positive economics is to describe and explain economic reality. The function of normative economics is to help improve it. This means taking account of historical experience, of political and institutional considerations, of psychological motivations that are poorly understood, and ethical values that are usually only dimly recognised. Otherwise it becomes a sterile – and possibly harmful – activity.

NOTES

1. Okun, 1975.
2. Research carried out by Rebecca Riley at the National Institute of Economic and Social Research in 2009 also found only a slight influence of the introduction of a minimum wage in Britain in 1999 on the hours worked by low-paid adult males and virtually no influence on employment opportunities for low-paid women, who constitute the majority of low-paid workers.
3. See 2009 Annual Report of the National Institute of Economic and Social Research, p. 13.
4. Wolf, M., *Financial Times*, 26 September 2007:15.