



## Economic Incentives and Liberal Equality

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### **ABSTRACT**

In order to assess to the degree to which the provision of economic incentives can result in justified inequalities, we need to distinguish between compensatory incentive payments and non-compensatory incentive payments. From a liberal egalitarian perspective, economic inequalities traceable to the provision of compensatory incentive payments are generally justifiable. However, economic inequalities created by the provision of non-compensatory incentive payments are more problematic. I argue that in non-ideal circumstances justice may permit and even require the provision of non-compensatory incentives despite the fact that those who receive non-compensatory payments are not entitled to them. In some circumstances, justice may require us to accede to unreasonable demands for incentive payments by hard bargainers. This leads to a kind of paradox: from a systemic point of view, non-compensatory incentive payments can be justified even though those who receive them have no just claim to them.

## INTRODUCTION

In this brief discussion, I consider whether economic inequalities can be justified on incentive grounds. More precisely, I examine the conditions under which a just economic system can provide individuals with economic inducements to engage in socially valuable labour when the provision of such inducements creates significant economic inequalities. We can call this the incentive problem. I address the incentive problem within the framework of principles of liberal equality.

Contemporary liberal egalitarians agree that some economic inequalities can be justified. Rawls, for instance, argues that economic inequalities are justifiable if such inequalities work to the benefit of the least-advantaged. Dworkin argues that differences in income arising from responsible choices of individuals can be justifiable providing certain background conditions obtain. Without expressly endorsing the details of either of these positions, I offer the following construal of liberal equality. It is, I think, in line with the animating spirit of contemporary liberal conceptions of justice. Liberal egalitarianism is committed to the creation of political and economic institutions which eliminate or at least reasonably mitigate the influence of morally suspect factors on distribution of the benefits and burdens of social cooperation while respecting individuals as equal persons who can assume responsibility for the choices they make about how to conduct their lives. The justification of economic inequalities depends on the satisfaction of three general conditions. First, the existence of economic inequalities must be compatible with ensuring the basic dignity of human beings. Second, insofar as possible, economic inequalities should not be directly grounded in traits of persons or features of their circumstances for which they cannot claim credit. Avoidable inequalities that track morally arbitrary features of persons or their circumstances are presumptively unjust. Thus a just distribution of economic resources should not confer advantages or disadvantages on persons in virtue of considerations of race, sex, religion, family background or disability. Socially valuable natural talent is also often viewed as a morally arbitrary factor. Highly talented individuals should not, in virtue of their fortuitous natural endowment, have access to better life prospects or a greater share of resources than those with less valuable talents. Economic remuneration should not track natural talent per se. But not all sources of inequality are arbitrary. Access to economic resources can be legitimately influenced by production, consumption, leisure, effort and risk-taking choices made by responsible individuals.<sup>1</sup> Third, insofar as there are factors in virtue of which inequalities can be justified, there should be proportionality between the factor that creates an inequality and the size of the inequality it generates. For instance, although differences in individual choices can justify economic inequalities, the magnitude of the inequalities generated via differences in individual choices should be roughly commensurate with reasonable assessments of the relative significance of different choices. For example, although

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<sup>1</sup> Other factors, such as the demandingness, unpleasantness, dullness or dangerousness of employment, may also legitimately influence remuneration.

we may reasonably hold that, other things equal, a person who chooses to work 50% longer than another is entitled to a higher income, it would be unfair to pay the harder worker a salary 5 times greater than the other worker. In other words, the choice-benefit function governing fair remuneration should be reasonable in various ways. It should, for instance, be sensitive to more than merely procedural standards of fairness.<sup>2</sup>

Together these considerations provide an abstract account of fair economic remuneration or compensation. In sum, economic inequalities can be justifiable if they are: (a) compatible with human dignity (b) generated via suitably non-arbitrary factors and (c) suitably proportional to the non-arbitrary factors which legitimize them.

### **INCENTIVES, JUSTICE, AND THE OBJECTIVES OF SOCIAL COOPERATION**

An incentive is some kind of inducement aimed at motivating an actor or a set of actors to act in a particular way deemed valuable by another actor or set of actors. Incentives can be distinguished from deterrents. A deterrent is a socially imposed negative consequence that attaches to actions deemed harmful or undesirable by some part of society. Deterrents aim at discouraging conduct whereas incentives aim at encouraging conduct.<sup>3</sup> The inducements that can constitute an incentive are diverse. They include a wide array of personal benefits – e.g., income, prestige, affection, and pleasure – as well as inducements grounded in impersonal values – e.g., aesthetic, moral or political ideals. Deterrents are similarly diverse in character ranging from criminal punishment and fines to various forms of social disapprobation. Incentives grounded in impersonal values and parallel kinds of deterrents play an important and underappreciated role in motivating and regulating human behaviour. Individuals can, in the name of honouring ideals, be induced to make enormous social contributions that entail huge sacrifices on their part. Nonetheless, I shall limit my discussion here to more familiar material incentives such as personal welfare benefits linked with increased income and expressly punitive deterrents entailed by coercively enforced laws.

There are countless ways in which schemes of human cooperation can be arranged and each way of organizing social cooperation will provide a general set of incentives and deterrents that shape the objectives that are pursued via cooperation and the manner in which the objectives are pursued. A broadly free market economy

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<sup>2</sup> Some risk-taking choices available in market settings are fair gambles in the sense that the terms of the gamble are available to all on the same basis. However, the outcome of a fair gamble in a market setting need not be fair. A procedurally fair gamble that persons enter into freely can generate unfair outcomes if the relation between the choice to take the gamble and the possible loss or gain is itself unreasonable.

<sup>3</sup> In practice, the distinction between an incentive and deterrent may not be neat. Arguably one way of encouraging 'good' behaviour is by sanctioning 'bad' behaviour.

with a coercively enforced set of private rights provides a familiar framework of social cooperation that embodies a complex but malleable set of incentives and deterrents. The goods produced via market interaction and the manner in which they are distributed will be determined by a host of complex factors including the initial allocation of material resources, the distribution of natural talents amongst the population, the scope and character of legal regulation of economic matters including the tax system, the kind of educational opportunities that are available to facilitate the development of talents, and the preferences of economic actors. For any given configuration of the market, we can ask how satisfactory it is from the point of view of justice and whether there is a feasible alternative to it that is preferable.

The incentive problem arises in the context of regulating<sup>4</sup> the terms of market interaction in a way that: (a) respects the basic rights and entitlements of persons and (b) effectively facilitates the achievement of valuable social objectives. The goals that can be pursued are diverse and differ in normative significance, but a rough threefold distinction between kinds of objectives may prove helpful. First, some objectives of social cooperation are linked to the meeting of basic human needs that are integral to human dignity. It is particularly important that social cooperation be organized so as to provide persons with the prerequisites of security including access to adequate food, shelter, and basic health care. Call these 'dignity objectives'. Second, there are 'autonomy objectives'. Social cooperation can be organized so as to facilitate the development of autonomy but also in a way that creates opportunities for persons to express autonomy in meaningful and valuable ways. The creation of a diverse and vibrant culture is an autonomy objective. Third, there are 'welfare objectives'. We may organize social cooperation in ways that enhance genuine but not crucial aspects of human welfare – e.g., through the establishment of an economic system that produces a wide variety of consumer goods.

Considerations of justice play at least three roles in relation to pursuit of different social objectives. First, there are standards of justice that bear upon assessment of possible goals of social cooperation. Some goals, such as the production of sufficient resources to meet basic needs, are themselves requirements of justice. Justice prohibits other possible goals, such as the creation of a market of child prostitution. And some goals are compatible with justice but not required by justice. Increasing production of luxury consumer goods may be a permissible and even desirable objective of a democratic society but it is not a requirement of justice. Second, considerations of justice play a role in determining the means through which (permissible) social goals may be pursued. For instance, an economically efficient system for the production of consumer goods may be impermissible if it depends on exploitative labour practices. Third, considerations of justice play a role

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<sup>4</sup> Regulation may include schemes of redistributive taxation, direct state control over the provision of some goods such as education and health care, as well various other policy devices such as labour legislation, subsidy programs etc. that affect market interaction.

in determining how the permissible benefits and burdens of social cooperation should be distributed.

### **THE INCENTIVE PROBLEM IN IDEAL AND NON-IDEAL SETTINGS**

In principle, there need be no tension between liberal equality and a suitably sophisticated system of incentives and deterrents. We can imagine an economy with a tax and regulatory regime that provides the conditions of human dignity, facilitates meaningful autonomy, promotes welfare and distributes the benefits and burdens of cooperation in a way commensurate with liberal egalitarian distributive principles. This is a coherent ideal. In practice, however, things are more complex for a number of reasons. First, there are deep practical epistemic obstacles to determining how the complex mix of choice and endowment that displays itself in economic settings should affect rates of fair compensation for economic activity. For instance, some portion of the income that highly talented individuals can obtain in a market economy reflects choices they have made about producing goods and services valued by others. Yet the fact that they are in a position to make such choices is partly the result of arbitrary factors for which they can claim no credit and in virtue of which they are not entitled to extra income. But how can we reliably distinguish and track the significance of choice and endowment in a way that allows us to identify what fair compensation consists in? The best we can hope for are approximate standards of fair compensation that are broadly faithful to liberal egalitarian distributive norms.<sup>5</sup> Second, and perhaps more importantly, variations in the bargaining dispositions of agents can lead to tensions between different dimensions of egalitarian justice that raise the incentive problem in an acute way. To set the stage for consideration of this problem, let me articulate a few background conditions that give shape to the incentive problem for the liberal egalitarian.

First, let us assume we have a satisfactory solution to the epistemic problem. We have, in other words, a practical account of fair compensation that is faithful to liberal egalitarian distributive norms. Second, assume that we can identify various social objectives we hope to achieve via social cooperation and that we know how to configure economic policy in a way that is compatible with the realization of these objectives. To illustrate these two assumptions, imagine that a government wishes to provide basic medical services to remote regions and that we have identified what fair compensation for doctors working in remote areas consists in. Salary bonuses will provide an incentive for doctors to relocate. Third, assume that the economy operates within the constraints of a principle of occupational liberty according to which individuals are permitted to decide, from the range of available opportunities for which they have the requisite skills, which occupations to pursue and which

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<sup>5</sup> The relevant criteria may be influenced by market forces but they cannot wholly be determined by them.

employment offers to accept.<sup>6</sup> Finally, assume that individuals in the economy have different bargaining dispositions. Some are what might be called 'fair bargainers'. They are disposed to accept remuneration that provides fair compensation for the services they are in a position to render. Others are 'hard bargainers'. They are disposed to wield their bargaining power to extract the highest income they can obtain even where this grossly exceeds fair compensation.

If only fair bargainers were present in the economy, the provision of inequality-generating incentives would not be problematic. This is because economic inducements to perform socially valuable services would be in line with reasonable standards of fair compensation. Incentive payments would, in other words, be compensatory. In our example, salary bonuses would appropriately compensate doctors for working in demanding conditions. Such incentive payments create economic inequality but, provided the extra salary constitutes fair compensation and provided the payments will induce a sufficient number of doctors to relocate, the inequality does not offend egalitarian norms and it will succeed in advancing the valued social objective. Since fair bargainers are disposed to accept fair remuneration, justice and inequality-creating incentives are in harmony. In this rather idealized setting, there is a straightforward response to the incentive problem. Compensatory incentive payments which generate economic inequality are compatible with liberal egalitarianism.

Of course, the foregoing response to the incentive problem rests on optimistic assumptions. The trickier and more realistic version of the incentive problem concerns the provision of incentive payments to hard bargainers. The principle of occupational liberty gives talented hard bargainers leverage which they can wield to extract remuneration that exceeds fair compensation. Consider how the presence of hard bargainers changes the dynamics of the foregoing case. Suppose that doctors refuse to relocate to remote areas unless they are given salaries that greatly exceed fair compensation. Given the principle of occupational liberty, the government cannot compel doctors to provide the needed services for a fair salary. In this case, an incentive payment large enough to secure the services of the doctors will generate an unjust inequality.

There is consequently a strong *prima facie* case against the provision of non-compensatory incentive payments – i.e., payments that induce agents to provide valued services but which exceed fair compensation for those services. Nonetheless, in many circumstances, the failure to provide non-compensatory incentive payments will frustrate the realization of valuable social goals. Some of these goals may be sufficiently important to override the presumption against the

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<sup>6</sup> Non-liberals might reject the principle of occupational liberty and might maintain that persons can be compelled by the state to perform socially valuable labour. But aside from the questionable efficacy of such coercion, liberals can object that, outside of times of extreme crisis, denial of occupational liberty is inconsistent with respect for the autonomy of persons.

provision of non-compensatory incentive payments. For instance, the achievement of social goals which are themselves basic requirements of justice can justify the provision of non-compensatory incentive payments. If the only feasible way of ensuring that individuals have the basic goods that are integral to dignity is through the provision of non-compensatory incentive payments, then such payments are justified. Somewhat paradoxically, those who receive such payments are not entitled to them even though justice requires that they receive them. There is also a good but somewhat weaker case for the provision of non-compensatory incentive payments in the pursuit of important autonomy objectives. The normative significance, from the point of view of justice, of facilitating meaningful autonomy is arguably sufficient to mitigate the unjust inequality created by non-compensatory incentives. However, the use of non-compensatory incentives in the pursuit of welfare goods that are compatible with but not required by justice seems more difficult to reconcile with liberal egalitarianism. In general, the less important the good is from the point of justice, the less reason there is to provide non-compensatory incentive payments in order to secure it. Whereas justice requires us to provide non-compensatory incentives if doing so is necessary to the provision of basic health care, such payments are not required and may not even be permissible in order to secure an otherwise desirable increase in the production of consumer goods.

## CONCLUSION

In order to assess to the degree to which the provision of economic incentives can result in justified inequalities, we need to distinguish between compensatory incentive payments and non-compensatory incentive payments. From the point of view of egalitarian justice, economic inequalities traceable to the provision of compensatory incentive payments are generally justifiable. However, economic inequalities created by the provision of non-compensatory incentive payments are more problematic. I have suggested that in non-ideal circumstances justice may permit and even require the provision of non-compensatory incentives despite the fact that those who receive non-compensatory payments are not, from the point of view of justice, entitled to them. In some circumstances, justice may require us to accede to unreasonable and unfair demands for incentive payments. This leads to a kind of paradox: from a systemic point of view, non-compensatory incentive payments can be justified even though those who receive them have no just claim to them.