If It’s Not Your Talent, How Come We Should Be Paying You an Incentive?

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Abstract

The idea that pushing for more equality comes at a cost in terms of economic efficiency is widely accepted. Underpinning this idea is the premise that some of the most productive members of society will work less if we lower their pay. If this is true, some argue, it justifies paying the most productive an incentive to work, provided doing so benefits everyone. This paper argues that the standard version of the incentives argument suffers from two important blind spots. First, it assumes that the comparative advantage of the most productive members of society is rooted in their natural talents, that is, in a factor exogenous to the production process. Second, it adopts a static framework to analyze the bargaining process in which incentive payments are negotiated, where static means taking all its informational inputs from the same moment in time. The paper uses the debate between John Rawls (1999) and GA Cohen (2008) to illustrate the normative repercussions of making these two assumptions. Taking their debate as a starting point allows us both to bring a new perspective to this intellectual exchange and to draw some important general lessons for public policy making on the issue of incentives. What happens when we relax the two assumptions? First, once we allow for comparative advantage to arise at least in part from endogenous rather than from exogenous factors, this puts into perspective the idea that the productive success of society depends to a significant degree on the contribution of a select group of talented individuals. Endogenous factors here refer to the way production is organized and how labour is divided between different individuals, rather than to the natural talents they bring to the cooperative venture. Incentive payments that track endogenous comparative advantage are unjust, arguably even from a Rawlsian perspective. However, prima facie, it may still seem expedient in many circumstances to pay them nonetheless. This changes once we relax the second assumption and shift to a dynamic framework to assess incentive payments. When the bargaining with individuals takes place before they even acquire the qualifications that underpin their endogenous comparative advantage and that give them bargaining power, they will not be able to extract incentive payments. Thus, adopting a dynamic perspective allows us to close the gap between the demands of justice and expediency. Finally, the paper discusses the objection that eliminating a certain type of incentive payments would be inefficient. In fact, once we correct for the two blind spots of the standard conceptualization of incentives, incentive payments that track endogenous comparative advantage emerge as a form of economic rent. As such, eliminating them is not only an imperative of justice, but also a requirement of efficiency. Pushing for more equality, it turns out, does not necessarily come at a cost in terms of economic efficiency after all.