

The Rhetoric and Reality of Income Redistribution

Gordon Tullock



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Preface

This fifth Occasional Paper publishes an address delivered at the Centre's third Occasional Seminar on July 10, 1981 by Professor Gordon Tullock, University Distinguished Professor of Economics at the Center for the Study of Public Choice, Virginia Polytechnic Institute and State University. The paper has previously appeared in the *Southern Economic Journal* of April 1981 and we thank its publishers for permission to print this slightly edited version.

Income redistribution is an overwhelming part of the program of all governments and it is natural to assume that the main aim of redistribution is to help certain, usually less well-off, sectors of the community. At least that is the rhetoric.

According to Professor Tullock there are various motives for redistribution. Traditionally people wish to help the poor; there is a desire for income insurance; and we periodically envy the rich. We should not be blind however, to another, and major form of redistribution. The motive in this case he says, is simply 'the recipient's desire to receive the money'. This transfer goes to people 'who from any external characteristic are not particularly deserving'.

The nineteenth century French political economist, Frederic Bastiat, once said that 'the state is the great fiction through which everybody tries to live at the expense of everybody else', but the reality is that some groups more ably use the state to redistribute income to themselves than others. Protection, regulation and subsidisation of industry for instance, are all transfers of income from consumers and taxpayers to the members of the various industries. Salaries of academics and the provision of free or subsidised education are also examples of transfers from people who may not wish to spend their money in that particular way. This type of redistribution is a far more prominent feature of government programs, but is not often seen for what it is.

The concentration on intranational redistribution and the tendency to regard problems in other countries in a different way from our own, are also noted by Professor Tullock. Richer countries usually give aid to poorer nations

but, as described recently by Samuel Brittan, this amounts to little more than 'conscience money', given the trading policies of so many of the richer countries.

These ideas about redistribution and much of the hypocrisy which surrounds them are the subjects for discussion in this paper. Professor Tullock's plea isn't so much that we should change our thinking, but more that we should 'not pretend we are doing something we are not . . . that we should not use as an explanation for our income transfer programs a rationalisation which does not fit our actual behaviour.' There **are** immense redistributions but the actual policies we observe often cannot be justified by the normal ethical arguments, so, if these transfers are to stay with us then 'let us at least speak the truth about them.'

In the discussion of this important issue, Gordon Tullock has injected some of his characteristic commonsense into the debate. Nevertheless, his conclusions are his own and while the Centre for Independent Studies is pleased to be able to publish this Paper, the views of the author are not necessarily Shared by the Centre, its Advisers, Trustees, Directors or officers.

September, 1981

Greg Lindsay

The Author

Gordon Tullock is University Distinguished Professor of Economics in the Center for the Study of Public Choice at the Virginia Polytechnic Institute and State University. He has also taught at the Universities of South Carolina, Virginia and at Rice University. He is editor of *Public Choice*, co-author with James Buchanan of *The Calculus of Consent* and author of many books including *The Politics of Bureaucracy*; *Private Wants, Public Means - An Economic Analysis of the Desirable Scope of Government*; *The Sources of Union Gains*; and *The Vote Motive*. He has also published over 100 articles etc. in journals and magazines worldwide.

The Rhetoric and Reality of Income Redistribution

Let me very briefly survey the existing economic, as opposed to the philosophic, literature on the redistribution of income. Firstly, a good many economists have said simply that economics can say nothing about the subject because somebody gains and somebody loses, but we can't say whether this is a good or a bad thing with our economic apparatus. Hochman and Rodgers [9] * have started another tradition of dealing with income redistribution in which the government is seen as simply organising what is essentially a voluntary transfer from the better-off citizens to the less well-off citizens. Why the government should be used as an instrumentality for this kind of transfer was, interestingly enough, first explained by Milton Friedman [6, pp. 191-192]. Such redistribution has the interesting characteristic that it does not actually involve redistribution because the people who make the gift are maximising their own utility and, hence, are better off. It is a case in which human preferences are so arranged that a given dollar of income benefits two people a full dollar's worth. The donor gains a dollar from expending money at its best use, to him, i.e. making a gift to the poor, and the poor gain the dollar. In a somewhat metaphysical sense, it can be said here that no one is really coerced into reducing his own living standard for the benefit of others. Coercion is necessary but solely in order to avoid free riding.

To put the matter in purest terms, unanimous agreement among the donors could be obtained to use coercion to get each one of them to make a given size gift. The problem

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Numbers in square brackets refer to the References at the end of this Paper (p. 21)

is very similar to that of hiring policemen. In practice, of course, nothing anywhere near as perfect as that exists, but I do not doubt that this particular charitable motive is, in fact, among the reasons for income redistribution in the most modern states. We will argue below that it is a relatively minor motive and the major motives tend to lead to inefficiency and distortion. This particular motive, insofar as implemented, actually improves the efficiency of the economy.

The main theme of this paper, however, is not that Hochman, Rodgers, and Friedman are right, but that a great deal of the other argument for income redistribution is wrong. Let me begin my discussion of this by a brief digression on South Africa, a country which I visited recently.¹ In South Africa, the whites run a system which is quite democratic if you ignore the fact that only whites can vote. They have used this system to establish a fairly elaborate welfare state for the benefit of the white population, particularly the Afrikaners who are about half employed by the government. Significant transfers are made to 'poor whites' who are defined roughly speaking as white people whose income is lower than that of most whites and only three times as high as that of most blacks.

The blacks are also the subject of some income transfers from the whites. These transfers are not large but they are real. It is I must admit conceivable, although I think not true, that those whites who administer the transfer program receive benefits that are larger than the black community nets out on the program. Nevertheless, I think that there is a real transfer of resources to the black part of the population, albeit a small one. The blacks, however, have much to complain about. They are subject to a good deal of discriminatory regulation. Most of these discriminatory rules are essentially minor annoyances, but rules which keep at least half the blacks on what used to be called reserves and are now in the process of being called homelands, make it impossible for most of the blacks to make the best of their human capital. It should be said, by the way, that the black human capital is very sharply lower than the white, and hence, in a completely free economy, black incomes would be significantly lower than white incomes, but not nearly as much as they are under present institutions.

¹ The discussion of South Africa here is extremely oversimplified, but I think it properly presents the spirit of their institutions.

Once a black has permission to get a job in Johannesburg or wherever it is, he is then subject to some further controls on the type of job he has but these in general do not seem to be very important. There are some exceptions which permit certain white employers, the Afrikaner farmers for example, to guarantee themselves adequate labor supplies at fairly low cost but that is a comparatively small phenomena. There are, of course, in the cities also a great many illegal immigrants working hidden in the interstices of the economy. Indeed, the present government, as part of its 'liberalisation' procedure, has eased up on them and permitted many of these illegal immigrants to become legal. As would be expected, the result of this is that the salary of all blacks has risen but that of the blacks who formerly were legal and who now face more competition has fallen. The blacks in the city are dealt with by a special police force which has the right to arbitrarily deport them although there is, of course, the possibility of appeal to courts.

Most people to whom I describe this system are shocked. The fact is that the system is identical to the one used by the United States and, indeed, all Western European countries. The only difference is our tradition that foreigners are not really human. What I have said about South Africa's treatment of its blacks is identical say, to America's treatment of Mexicans. They are kept on their 'homelands' by what we call immigration control. Those who get into the United States are subject to restrictions on what they can do if they come in legally, and there are a great many of them in the country illegally who are subject to arbitrary deportation although, again, with the right of court appeal if they want it. As a result, the living standard of the Mexicans is very much lower than it would be without this rule.

The United States, in this respect, is less close to South Africa than are countries like Sweden or Switzerland. In both of these countries very large parts of the labor force are admitted into the country on a legal status which is to all intents and purposes the same as that on which a South African black gets permission to work in Johannesburg. They are confined in general to the low paying jobs and, of course, the salaries in these jobs are much lower than they would be if they were not there to keep the price down and serve as a complement rather than a substitute for the Swedish, Swiss, or white South African laborer. As a result, living standards of the Swedes, Swiss, and white South Africans are higher than they would be otherwise. The living standards of the

Turks, Yugoslavs, and Zulus are also higher than they would be if they were not permitted to immigrate to these upper class areas at all, but markedly lower than they would be if they were permitted to freely immigrate.

The only distinction between the case of the United States and the Mexicans, the Swedes with the Turks, Swiss with the Yugoslavs, Italians, etc., on the one hand and the South Africans with respect to the blacks on the other, is that it can be argued that the blacks of South Africa are citizens of South Africa. Legally, of course, they are not and, indeed, the South African government is in the process of setting up a whole series of 'states' so that they will have other countries in which they can be citizens, but most advanced liberal thought feels that they should be citizens of South Africa.

But why should the Turks in Sweden be subject to the same kind of discrimination that the blacks are in South Africa? Why is it any worse for the South African government to prohibit more than a fixed quota from leaving one of the new Bantustans, and going to Johannesburg and seeking work than it is for the government of Sweden to prohibit more than a fixed quota of Turks from working in Sweden? England now is actually changing its definition of citizenship so that there will be formal citizens of England² who have access to British passports and travel around the world as British citizens but who may not settle in England. But for that matter, why when the British Labor Party took control of the British Empire in 1945 did they give India independence instead of inviting India to send delegates to the House of Commons?³ They would, of course, immediately have taken over the House of Commons since their citizenry were so much more numerous than that of the English, but why not?

² Actually they are subjects of the Queen.

³ Friedrich Hayek once noted that:

If an English proletarian, for instance, is entitled to an equal share of the income derived from his country's capital resources, and of the control of their use, because they are the result of exploitation, so on the same principle all the Indians would be entitled not only to the income from but also to the use of a proportional share of the British capital. . . .

But what socialists seriously contemplate equal division of existing capital resources among the people of the world. [8, pp. 222-225]

These questions, I think, most people would regard as simply silly. We have built into us a very, very strong feeling that we do not want large reductions in our income. The proposals I have just made would lead to large reductions in the income of the Swedes, the Swiss, South Africa's English, and the citizens of the United States. Further, they are contrary to a particular tradition; the tradition of nationalism. We treat our fellow citizens differently than other human beings.

Now I am not arguing that we should accept any Mexican or Indian who wishes to come to the United States and take a job. Indeed, I think that would very sharply lower the living standards of most Americans, although it might in my own particular case lead to an improvement. What I am saying is that we should recognise that our motives in objecting to this are simply selfish.⁴ We want to keep our living standards up and we are willing to let people die in southern India to that end. But we don't like to talk about it. This is the hypocrisy which dominates discussion of this issue.

There are immense difference between the incomes received by the Americans, northwest Europeans and Australians and those which are received by the majority of the human race living in places like India and Zaire. Further, the transfer of, let us say, half of our incomes to them presents no technical difficulty although of course, it would take a little while to organise. Note that even if the northwest Europeans, the Americans, the Australians, Japanese, etc. decided to transfer half of their current incomes to the poorer part of the world, they would continue to have expenditure levels which were markedly higher than those of the recipients of their charity. If we believe what is frequently referred to as the Lerner justification for income redistribution, declining marginal utility of income with wealth, the transfer should lead to a very large increase in the total world utility.

Recently, Willy Brandt was head of a commission composed of professional bleeding hearts from the developed part of the world and a group of representatives of the poorer part of the world. With great fanfare, they released a report [10] pointing out how badly off the poorer parts of the world were. Despite all the strong statements about the desirability of aid, their principal actual suggestion was that a schedule of transfers from the developed to the under-

⁴ For an unselfish argument, see Charles R. Beitz [1]

developed world be produced such that 7/10th of 1 per cent of the income of the developed world be transferred in 1985 and 1 per cent in the year 2000 [10, p. 291].⁵ Seldom has such a large mountain labored to produce such a small mouse. Further, there does not seem to be any real prospect of even these extremely modest recommendations being implemented. Once again I do not object to this policy. I would very much prefer continuing my present habits of life even though I am aware of the fact that if I transferred half of my income to the poorer parts of the world, I could save perhaps 30 children.

Indeed, we do not need to consider only government action here. Any one of us who wishes, by deciding to dedicate half of his income to the task and by taking a little trouble to make certain it actually is delivered, could roughly double the living standards of perhaps 20 citizens of south India. I take it no one in this audience is in fact going to take advantage of the opportunity and I also take it that the bulk of you will remove it from your memory banks as soon as possible. Indeed, some of you may devote a good deal of time to producing rational explanations as to why this is not possible. As Benjamin Franklin once said, 'It is so convenient to be a rational animal because it permits us to rationalise anything we choose to do.'

Note that I am not criticising you or myself for being more interested in our own creature comforts than preventing starvation in other parts of the world. It seems to me quite normal human behaviour. Nor am I criticising you for normally avoiding thinking about this matter. After all, why should one torture one's self by thinking about something which one could do but does not intend to. What I am saying is that we should not use as an explanation for our income transfer programs a rationalisation which does not fit our actual behaviour. This, of necessity, will lead to a less efficient achievement of our actual goals in income redistribution than more careful and accurate thought.⁶

Let us take Rawls, for example. Here I am going to discuss only one aspect of his argument which is the view that we should make decisions about income transfers as if we were behind the veil of ignorance. He specifically says that

⁵ There are some other proposals but they are equally trifling.

⁶ But see my review of *Tragic Choice* [3] in the *New York University Law Review* [16]

this is only for one 'isolated' society.⁷ In other words, behind the veil of ignorance you know that you are a citizen of Australia or America. Now there are only two explanations for this. The first is that he is not talking about the real world. The immigration code, the existence in the United States of many illegal Mexicans in our cities, for that matter the existence of some 50,000,000 Mexicans right next to us all of whom would like to come in, the Cubans and the Haitians - to say nothing of the citizens of India and Egypt - all are to be ignored in deciding about income distribution.

Why? The only explanation I can think of is that it would be painful to think of them. The moment we begin talking about being behind the veil of ignorance as human beings rather than citizens of a very wealthy country, Rawls' line of reasoning indicates that our income should be reduced to an immense degree. If this had been clearly pointed out, I would predict that the book would not have been the best seller that it was nor would it have had the great public discussion, mainly approving of the book. What we actually observe in the real world is a very elaborate income transfer

⁷ Rawls is a bit hard to pin down on this subject. The only discussion I have been able to find is in the latter part of a paragraph, the first part of which purports to deal with international law. Here he says:

. . . I shall be satisfied if it is possible to formulate a reasonable conception of justice for the basic structure of society conceived for the time being as a closed system isolated from other societies. The significance of this special case is obvious and needs no explanation. It is natural to conjecture that once we have a sound theory for this case, the remaining problems of justice will prove more tractable in the light of it. With suitable modifications such a theory should provide the key for some of these other questions. [15, p. 8]

Note that we do have a 'closed system isolated from other societies' in the form of the world. We also have other systems such that the United States which empirically is certainly not isolated from Mexico, Sweden which is certainly not isolated from Turkey, and White South Africa which is certainly not isolated from Black South Africa. If we accept the world as a closed system, Rawls is calling for immense transfers from us to the citizens of India, Africa etc. If we take any smaller area, we do not meet his conditions.

system which is mainly internal to individual states.

Indeed, men of good will travelling in India and observing the abominable poverty of almost the entire citizenry of that country, will complain about the government of India not engaging in enough redistribution within the country. Apparently it never occurs to them that they themselves could by giving away half of the difference between their own income and the income of the average Indian, actually raise the living standard of a considerable number of Indians.

They certainly never seem to show much recognition of the fact that the financial resources of the government of India are very, very small, granted the problem which they face and the financial resources of the United States and western Europe are large enough so that we easily could transfer to the poor in India much more than the absolute maximum that could be obtained by the government of India. It is, of course, true that visitors frequently say that the American and European aid program should be larger and, granted the trivial size of these aid programs this is an easy argument to make, but they never suggest that we consider all human beings as roughly equivalent and that a current transfer to an American living in Harlem who feels discriminated against because he or she does not have a color TV set, could be sent to south India where they might well prevent 15 to 20 deaths a year from malnutrition.' However, in practice we observe that the United States and western Europe engage in large scale transfers to their own citizens who they regard as poor but who by world standards are clearly wealthy, being normally in the top 10 per cent of the world income distribution, rather than transferring to the very poor.

Now once again, I am not criticising this behaviour on the part of the countries concerned. It, in fact, is in accord with my own preferences. I am, however, saying that we should talk about the matter in realistic terms. We should not pretend we are doing something we are not, and we should

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One of the rationalisations that I frequently encounter at this point is the concern about the effect on population of transfers to south India. The effect on the population of the United States of the Aid for Dependent Children Program is normally ignored. In any event, however, if this is a concern, transfers could be made contingent upon suitable birth control methods. On the whole, utilities in south India will be higher if the population is kept down by birth control rather than by starvation.

try to clarify our own motives so that we can select institutions which fit what we want to do and not what we think it pleasant to say we want to do.

It should be pointed out that the income transfers within the wealthier states actually lower real incomes in the poorer states, albeit not by very much. Income transfers within any group will lower the total measured income of that group (albeit they might increase total utility) because it makes the marginal return on labor lower while the wealth effects tend to cancel out. Poor people are made wealthier and the wealthy people are made poorer. Empirical measures of this are relatively difficult but the negative income tax experiments seem to indicate that a not very aggressive income redistribution scheme would reduce production by about 10 per cent.⁹

Since there is a world market in many things, this would mean that the surplus value generated in the poorer countries by greater production in wealthier countries is reduced because of the income transfer schemes in the wealthy countries. Put differently, the things that the poorer countries buy from the wealthy countries will be somewhat more expensive and the things that they sell to wealthy countries will be sold for somewhat lower prices than they would without this program.

It should be said by the way, that there is at least a possibility that direct large scale transfers from the wealthy countries to the poor countries would actually increase measured production. The marginal utility of labor would of course go down in both countries, but in the wealthy countries the reduced real income of each individual might partially, or on the whole, cancel that effect out with the result that the amount of work done was about the same. In the poor countries, malnutrition, physical weakness, etc., caused by poverty lowers the amount of work that a man can do. It might be that these transfers by getting around these physical limits would produce more work there. But this is merely a possibility. I would hate to argue strongly for its reality.

So far I have been primarily arguing that the standard rationalisation for income redistribution policies does not fit. Why then do we engage in income transfers? Surely they are by any measure an extremely important function of most modern states. Further, historically, they have normally been important, albeit not as important as now.

9 See [12]

THE MOTIVES FOR REDISTRIBUTION

There are, I think, a number of motives which lead to income redistribution. The first, and by all odds most important, is simply a desire on the part of the potential recipients of the redistribution to receive it. Since the donors normally do not wish to give money to people who simply want it, this leads to fairly complicated political difficulties which I will describe below. Nevertheless, I think it cannot be doubted this is the largest single explanation for income transfers in the modern state. The fact that so little of the income transferred goes to the poor is of course the obvious evidence for this. I presume you are familiar with the innumerable demonstrations that if our income transfers were concentrated on the poor, the poor would be wealthy even by American standards whereas, as a matter of fact, in spite of all the income transfers they are still very far from that enviable state.”

The charitable motive

But let me set this particular motive aside for the moment and turn to another set which, I think, undeniably does have some effect on our income redistribution policy. The first is what I would call charitable motives; Hochman and Rodgers call it interdependent utility functions, and this is - roughly speaking - our tendency to literally feel sorry for and want to do something for people who are worse off than ourselves. All human beings seem to have this particular motive to at least some extent, but it should also be said that for most human beings it does not seem to be very strong. I would suggest that the audience of this group consider how much of their income they have in fact given away to people poorer than themselves outside their immediate family.” If any of you exceed 5 per cent you will be either deeply religious or a most exceptional person. The deeply religious person who tithes, and this gets up to about 16 per cent all told with the Mormons, is not motivated by charity but by a desire not to burn in hell. It is a coerced transfer, albeit the coercion is attained not by a real threat but by a mythical threat. But if the myth is believed it is as real as a real threat.

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Of course they do appear wealthy from the standpoint of the citizens of India.

¹¹ Throughout this discussion, I am talking only about extra-family transfers. Intra-family transfers are, of course, immense,

Five per cent is, if we look at the income tax figures, actually a rather exaggerated amount for charitable transfers.¹² If we look at the other way in which charity can be organised, by the government, we normally observe that the amounts transferred to the poor are again well under 5 per cent of GNP. Indeed, I am always astonished at how small they are because after all the poor can vote and one would presume would be willing to concentrate their political support on people who would offer them larger payments. They don't seem to do anywhere near as well out of the political process as you would think they would, granted the number of votes they have.

Indeed, in spite of all the talk about the war on poverty in the United States, it is not clear that the poor do comparatively better than they did in 1850. Lebergott [14, p. 571 has assembled some figures which seem to indicate that we've had what amounts to a floor on income, which is about 25-30 per cent of the pay of common labour, throughout most of our history. His figures are not very good, not because he is inept but because the data he worked with are very thin, but they are the best that I know. I have often wondered if the poor did not perhaps do better under the combination of local payments and private charity directed to the poor in the 19th century than they do now with programs financed mainly by the federal government although partly by the states.

It is possible that the charitable motive tends to weaken as you move away from the charitable person, both in geographic distance and in social distance. If so, this would tend to indicate that citizens of your own country should be treated better than others. It would also, however, indicate that people of your class or people who live in your town should be treated better than other citizens of your country who are not either of your class or co-citizens of the town. I do not think that the sharp difference between citizens of the country and foreigners can be explained by this motive but it does perhaps tend to reinforce other factors that point in the same direction.

¹²

The income tax figures are somewhat hard to interpret because of the inclusion in the United States of religious gifts as charitable. They apparently make up about two-thirds of all gifts and the bulk of this money, of course, does not go to help the poor, but to build churches, pay salaries of ministers, etc.

The envy motive

The second real motive, and I do not know how strong this is, is simply envy. This is a mortal sin but it is one to which all of us are prone. It is very hard to avoid the impression that envy is an important part of the income redistribution program in most states. In most modern states, the wealthy in fact pay a more than proportional share of their income as taxes. It should be said, however, that of course some of the wealthy have gotten this large income by manipulating the government, but the cure for that is surely not to put a high tax on all upper income people. In spite of this there has been a great deal to do about the loopholes for the wealthy and very little attention about loopholes which all the rest of us have.

The explosion of public anger in the United States when it was revealed that there were 200 people with adjusted gross incomes of more than \$100,000 a year who had not paid taxes is simply one illustration of this point. It is a particularly good illustration because the reason they didn't pay taxes was that due to peculiar rules promulgated by the Internal Revenue Service, they were compelled to put down as adjusted gross income a figure which is very much in excess of their actual income. The tax was computed on their actual income and not on the adjusted gross income figure.¹³

It is quite widely believed by economists that the upper end of the income tax, and for that matter inheritance tax schedules, are high enough so that the actual tax revenue would be increased by lowering the rate. If this is so, then clearly envy is the only explanation, albeit this can be called (amongst economists) negative utility interdependence.

Personal experience here may be of some minor interest. I published an article in which I argued that the inheritance tax should be lowered to the rate which maximised revenue.¹⁴ This was severely criticised by three economists, none of whom denied that the present tax was above the revenue maximising level but all of whom nevertheless felt that the tax should be either increased or at least retained.¹⁵ Surely this is a clearcut example of the envy motive.

¹³ See Roger Freeman [5]

¹⁴ See Gordon Tullock [17]

¹⁵ See [7; 11; 13; 181]

I suspect, with respect to envy, that many people will assume that merely mentioning it is criticism and that we must either conceal it or fight against it. If I were a Minister of Religion, I might agree, but I am an economist and I take utility functions as they are. I find myself periodically envying people. I see no reason why we should not expect government policy to take into account real preferences.

It should, of course, be said here that envy does have the unfortunate characteristic that from a social standpoint it lowers total payoffs. If I earned a dollar and you were envious, the net effect on society of that dollar is less than a dollar because although it gives me a dollar's worth of utility, it gives you negative utility. This is depressing but aside from preaching I can think of nothing to do about it. Of course, if envy is strong enough, then taking a dollar away from me might give other people a total satisfaction which was larger than the loss of the dollar to me. Thus, plundering the Rockefeller family might be socially desirable if we had some way of measuring innate utilities.

The insurance motive

A third argument for income redistribution is one which I seldom see in the literature.¹⁶ I do occasionally run into it in conversation. This is the insurance motive. Risk is somewhat reduced if an institution is set up which will tax me if my income is higher and supplement my income if it is low. It should be said that this particular argument also provides a direct and immediate justification for the policy of the South African and all other governments of concentrating their transfers on their own citizens. The white South African may go broke, but he will not become black. Similarly, I may be forced into bankruptcy but I will not become a Mexican. White Englishmen will not become one of those Englishmen who are not white and whose passport does not permit them to live in England and have a share of the welfare state.

There are, of course, more subtle examples of the same thing. It is a matter of practical fact that ruling Communist parties provide arrangements under which communists who have difficulties do not fall to the same level as individual

¹⁶ *The Calculus of Consent* [2] is, of course, an exception; see Chapter 14.

citizens in their society.¹⁷ There used to be a society in England for the aid of distressed gentlefolk which saw to it that members of the upper class didn't fall to the level of the average worker. Similar institutions can be found in other areas. They are quite reasonable from the standpoint of the insurance motive, although not necessarily from other standards.

The selfish motive

But so far we have talked about what one might call general motives. Earlier I expressed the opinion that overwhelmingly the most important reason for income transfers in our society is or was desire on the part of the recipients to receive it. The farm program, high wages of civil servants, the particular activity I am engaged in - the development of human capital at a subsidised rate for people whose natural talent is such that they would already have a higher income than the average even without this capital - the price controls which have the purpose of transferring large amounts of wealth from American owners of oil wells to Arab Sheiks (about two-thirds) and American consumers (about one-third of the transfer) are all examples.

There is one obvious characteristic of these transfers and that is that they are highly inefficient. Take, for example, the transfer from the owners of oil wells to the American consumer and the Arabs. This has now been changed by the actions of President Reagan, but as far as I can see, the Arabs had substantially nothing to do with the institutions which led to this transfer. They were beneficiaries of programs, put in train by American politicians for the benefit of American consumers. In essence, for every dollar which was actually transferred to consumers, \$2 was, from the standpoint of the politician and the consumers, wasted. This was because the only simple, direct way of carrying out the transfer which would not have benefitted the Arabs would have been to put a tax on the owners of oil wells and use it to directly subsidise general expenditures of consumers. This was apparently politically impossible and so the highly inefficient scheme was adopted.

Further, it was normally discussed in highly misleading terms. I can recall being in Pittsburgh during the early part of the Arab oil embargo in 1973, and almost every day the Pittsburgh paper had two leading stories. One story would be

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Unless the difficulties are political, of course.

a relatively factual discussion of the Arab program for raising American prices. The other would be a denunciation of the American oil companies for putting the price of oil up. Since the oil companies were very nearly innocent bystanders of the whole thing, the only explanation for all of this is that it was possible for the Americans without much difficulty to put penalties on the oil companies but the only way of dealing with the Arabs would involve an invasion of the Middle East which most people didn't want to even think about.

I mention this particular example because it is characteristic of most of the cases where transfers are made simply because the recipient wants to receive them. These transfers are characteristically extremely inefficient. In addition to the inefficiency which we would expect that comes from switching the marginal return on income away from the actual marginal product, and the rent-seeking* inefficiency, there is normally another very large inefficiency which comes from the fact that the transfer has to be concealed as something else. A straightforward tax on the group of people who consume wheat with the receipts used to pay wheat farmers cash benefits would leave both the consumers and wheat farmers better off than they are under the present program. Further, this is well known to most economists. Indeed, when I was at the University of Chicago in the 1930s, it was frequently offered as a standard example of government ineptitude. But such a straightforward tax would never get through politically.

In the particular case given above of the oil well owners against the consumer and the Arab Sheiks, the consumers are immensely more numerous than the oil well owners. Most government transfers, however, are transfers to small, politically influential groups like the farmers, the civil servants, people who want to send their children to college and university, etc. There is no way of getting these transfers through if the simple straightforward method of cash payments is chosen. That is just a little too obvious. Deception is, in general, necessary in these cases, and the deception cannot take the form of simply lying - it has to take the form of setting up a structure which makes the

* Editor's Note: 'Rent-seeking' refers to activities undertaken with the aim of securing some privilege, e.g. a government hand-out. The real cost of these activities may, in aggregate, partly, wholly, or more-than-wholly outweigh the benefit being sought. Examples include queuing, lobbying and litigating.

transfer while purporting to do something else.¹⁸ Relative inefficiency which is generated by this type of deception can be very much greater than either the distortion of the margin or the ordinary rent-seeking cost.¹⁹

These inefficiencies are very large indeed. It is not clear, however, that we can do anything about this inefficiency. Economists have for a long time talked about government as a mechanism for providing public goods or dealing with externalities. It undeniably does this but in order to do so it must have coercive powers, and the use of these coercive powers to benefit people in terms of their political influence seems an obvious thing to expect from profit maximising individuals.

As a matter of historic fact, it would appear that the state originated out of a desire to make coerced transfer and began producing public goods and dealing with externalities as a by-product. We do not have very good data on the origin of the state but what evidence we do have seems to indicate that it started when some individual or small group with comparative advantage in the organisation of violence seized an area of land in order to compel the people living there to make transfers to them. Having the area, protecting it against other potential 'governments' was an obvious necessity in order to keep up tax revenue, and preventing private crime also had advantages. The building of roads, which of course originally were primitive tracks, as a way of improving the efficiency of the military in all of these activities, and in particular in suppressing local rebellions also occurred very early in the history of the state.

We should not be surprised about this, of course. As economists, we anticipate that people will produce cars not because they want to help the customers but because they want to make money. The fact that the state was set up originally because someone wanted to make money rather than because he wanted to provide public goods is also a profit maximising explanation. It is, of course, true that throughout history most governments have had as one of their major objectives a transfer of tax money quite directly from the ordinary citizen to Kings, nobles, government officials, etc.

¹⁸ For a good discussion of the role of 'obfuscation misdirection' see [4].

¹⁹ Of course, it could be regarded as simply part of the rent-seeking cost.

It seems likely that as a matter of fact the common citizen in most cases got a good bargain out of this since he was better off than he would have been without the government there. It is only when, we compare this kind of exploitive state with an ideal state, which exists only in imagination, that we can argue it is inferior.

Nevertheless, any economist looking at the existing democratic states in which so much money is transferred back and forth in the middle class in terms of political power and organisation is normally and quite justly appalled. The inefficiencies which come from changing the marginal return on effort and investment, rent-seeking costs, necessity of using deception, and the by-product of sometimes changing the whole nature of society, are immense. The question is, can we do anything about it?

The first thing to be said as if we are going to provide public goods, the justification for a government which most economists *use*,²⁰ we must use coercive taxation and the purchase of various resources, including of course services of government officials. Once this state exists then, it will begin to change the incomes received by the various people in the society. Producers of goods which the government needs will find their incomes are somewhat higher, people who are burdened with taxation will find theirs lower, etc. Thus, income transfers come from the very nature of the system. This is true even if we have a society which literally followed the Pareto optimal rules of always compensating losers.* There still would be some people who gained more from government activity than others and, presumably, some who gained not at all because their losses were just exactly compensated.

Real governments, of course, are not Pareto optimal and I think the idea in the back of the minds of most economists with respect to this kind of thing is that the government should undertake the bulk of its activities with a fairly simple, straightforward cost-benefit analysis in mind. It undertakes those activities where the benefit is larger than the cost and chooses taxes which have minimum excess bur-

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Here I include transfers to the poor to the extent that they are in fact desired by the population in general. This is apt to be a small extent but not zero.

* Editor's note: A change is said to be desirable on the Pareto criterion if it makes some people better off and makes no one worse off.

dens, etc.²¹ Income redistribution should then be handled by a totally separate organisation which arranges some taxes on the upper income groups to pay aid to people in the lower income groups. These are indeed two of Musgrave's three functions of government.

I will not quarrel with this as a conceivably desirable system although I think we can do better through the demand revealing process, but no real government is likely to do this. There will be people with power, even very modest power, who can use that power to change the pattern of purchases and taxes to their own advantage. The best that we can hope for is to make this a relatively minor phenomena. Further, looking at it from the perspective of academics, mainly government officials whose salaries are paid for out of coerced taxes, perhaps we should not even be in favor of minimising it but simply seeing how we can maximise our own incomes.

But assuming temporarily that we do want to have a system in which the waste which comes with income transfers from one part of the population to the other²² is minimised, what can we do? Unfortunately, there is not very much we can do in an immediate, direct way. If government purchases everything by the way of competitive bid, then one type of income transfer is to some extent reduced. It will still be to the best interest of various producer groups, however, to press for more purchase of their product and for individual producers to attempt to provide a lower quality than the bid actually calls for. Under modern circumstances the problem of exactly specifying the bid is so difficult that the negotiated bid, with its immense opportunities for transfer, may actually be more efficient than the competitive bid.²³ There doesn't seem to be any tax analogue of the

²¹ Of course the calculations are often very poorly done.

²² i.e. income transfers that are simply the outcome of the political process and pressure by the recipients, and which have not been adequately countered by pressure from the people who are taxed.

²³ I once worked for a company which sold a great many water wheel governors to the government. Over the years, their sales force had succeeded in gradually adjusting the government specifications for water wheel governors so that to all intents and purposes they had a monopoly. Transfers to them were probably large, although as a matter of fact they made excellent governors.

competitive bid, and hence taxes are pretty sure to be sources of inefficiency and income transfers. The rather traditional economic recommendation of some type of very broad based tax, whether it is the income tax, expenditure tax, value-added tax, etc., would seem to minimise the possibility of transfer in this area but it certainly does not eliminate it.

Further, these two types of recommendations more or less assume that the problem has been solved. If people can use political power to obtain transfers to themselves and other people find it necessary to use political power to attempt to avoid being the victim from such transfers, they are likely to fight over the type of taxes and the type of expenditures as well as other things. There does not seem to be any obvious reason why if we are able to get the government to accept purchasing and tax policies which would minimise these transfers, we would not be able to minimise them almost regardless of the purchasing and tax policies we have.

There is, I think, only one bright point in this particular area. That is that the transfers, generally speaking, require deception. If they are plain and above board, they normally cannot get through a democratic process. This seems to indicate that economists could have some influence with their educational function. Of course, I don't want to exaggerate their importance here, but the fact remains that in the United States the Civil Aeronautics Board is now in the process of disappearing, the Interstate Commerce Commission is exerting its regulatory powers much less than it was, and the Federal Communications Commission also is moving towards reducing its transfer component and producing a more competitive market. These are, very considerably, examples of response by the political apparatus to a simple economic argument. It turned out that economists **were** able to convince people. It was always true with respect to all three of those agencies, that a majority of the people were injured and it was only as long as the minority who benefitted kept this a secret that they could remain in existence. Breaking through this kind of secrecy is difficult because the average person has very little motive to become more informed on the activities of, let us say, the CAB. Nevertheless, it is not necessarily impossible and we should do the best we can.

But that very minor recommendation for reform is not the main point of this paper. My main point is simply that we should stop fooling ourselves about redistribution. We have a minor desire to help the poor. This leads to certain

government policies. We also have some desire for income insurance. And we also, to some extent, envy the rich. All three of these motives can lead to some redistribution but probably to a fairly small amount. Further, they aren't necessarily particularly noble. Elaborate ethical justifications for income redistribution normally cannot be used to justify the actual policies we observe in the world. The largest single source of income redistribution is simply the desire of the recipients to receive the money.

This leads to the immense redistributions we observe to people who from any external characteristic are not particularly deserving. Perhaps because I occasionally visit Eldora, Iowa, which is right next door to Grundy County, the wealthiest county in the United States at the moment, I tend to think of the farmers as the extreme example of this kind of beneficiary of transfer but there are many others. Academics for example. I shall not say whether there are any on this platform. Though we may personally benefit from these transfers, they all are negative sum games and extremely negative sum games. Society as a whole is injured and we are injured by the whole web of them. We would be better off if we could get rid of them. If that is not possible, let us at least speak the truth about them.

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