TAXATION AND INCOME REDISTRIBUTION: An Unsympathetic Critique of Practice and Theory

Richard B. McKenzie

The state is the great fiction through which everyone believes that he can live at the expense of everyone else.

Frédéric Bastiat

The United States has become to a considerable extent a redistributive society. The taxing power of the state continues to be used to transfer massive amounts of purchasing power from those who earn their keep to those relatively few who are truly in need and to those relatively many who are skillful in finding ways to remain on the receiving end of government handouts.

Many people now believe, and act as if, everyone can live at the expense of everyone else. As government welfare programs have expanded—or perhaps because of the expansion in those programs—democracy has been converted to a great extent into a competitive struggle over slices of the governmental welfare pie. The numerous groups who have an interest in the maintenance and expansion of the welfare system must now scramble for money in the political arena, fearful that their budgets will be allotted to someone else more skillful in securing political favors.

Large redistribution programs are a negative-sum, not a zero-sum, game: Redistributive efforts on the part of government reduce the incentive people have to work and to generate real output and income. However, given the considerable increase in welfare ex-

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Cato Journal, Vol. 1, No. 2 (Fall 1981).

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This paper was prepared for the Cato Institute's symposium "Taxation and Society," held at the University of Chicago in April 1980.

penditures in the last forty years, it takes a lot of imagination on the part of those playing the redistributive game to see that redistribution is ultimately destructive of the social product. At present, they see only the positive correlation between their redistributive political efforts and the expansion of the welfare system. Indeed, to argue successfully that political efforts to redistribute income are illogical simply because redistribution, on balance, reduces the national income, is extremely difficult.

A fundamental cause of the gross expansion in redistribution programs is relatively obvious: Government has become so open-ended that nothing is necessarily outside its purview. Stated differently, there are no longer constitutional restrictions on what government can do – for good or bad. It should surprise no one that people therefore seek to employ the power of the state in the pursuit of their own narrowly conceived ends. As a result, we have become a "constitutional anarchy," a phrase coined by James Buchanan and intended to suggest the social disruption that can occur when the power of the state is unbounded.

In this essay, we attempt to focus greater public attention on government as a redistributive force in society. We begin by briefly presenting data on the distribution of income and the effects that government programs have had on the distribution. We then critically evaluate traditional and not-so-traditional arguments for redistribution that presume to justify redistributing income from one sector, particularly the rich, to another sector, particularly the poor. The essay concludes with a discussion of social remedies for the redistributive trap in which the American – and British and French and German and any number of other – people find themselves.

Social Welfare Expenditures

The facts relating to governmental efforts to redistribute the nation's income reveal the stark dimensions of the modern welfare state and its limited ability to relieve what are perceived to be problems of absolute poverty and maldistribution of income. Table 1 reveals that in the 1980 budget the federal government alone planned to spend over $283 billion on social welfare programs (called euphemistically "human resource" programs). This level of spending represented a dramatic increase over 1955, a year in which social welfare outlays were only about $15 billion. Indeed, between 1955 and 1980 federal welfare expenditures increased by an annual compounded rate of nearly 13 percent. As is evident from the table, during the 1980 fiscal year the federal government expected to

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TABLE 1

FEDERAL BUDGET OUTLAYS [IN BILLIONS OF DOLLARS] FOR SOCIAL WELFARE PROGRAMS (HUMAN RESOURCES), SELECTED YEARS, 1955–1982

	1955	1965	1975	1980 (estimated)	1982 (estimated)
Total Social Welfare Outlays	14.6	35.4	168.7	283.2	324.9
Income Insurance	9.1	25.7	108.6	179.1	207.5
Health and Medical	0.3	1.8	27.6	53.4	64.2
Education	0.4	2.1	15.9	30.2	31.5
Veterans Benefits	4.7	16.6	16.6	20.5	21.7

SOURCE: *The Budget of the United States Government: 1980,* pp. 84–85.

spend $179 billion on income security; more than $53 billion on health and medical care; $30 billion on education; and about $21 billion on veterans' benefits. Federal social welfare expenditures are projected to be almost $325 billion in 1982. However, it should be kept in mind that these figures actually understate the federal government's welfare efforts. A complete accounting of federal welfare expenditures would include social programs embedded in the budgets for agriculture, housing, community and regional development, as well as many other programs.

Table 2 reveals the dramatic growth in social welfare expenditures at all levels of government.[1] In 1977, the latest year for which data are available for all government levels—federal, state, and local—government spent approximately $361 billion on welfare programs, fifteen times the amount spent in 1950. That type of growth in expenditures gives one the impression that the early 1950s are now a distant epoch as far as social politics are concerned. Granted, price and population increases distort upward the growth in welfare expenditures. However, even after being adjusted for price increases, which have occurred most prominently in the last decade, welfare expenditures in 1977 had grown more than sixfold since 1950. Per capita welfare expenditures (total expenditures divided by the entire population) grew by significantly

[1]Figures in table 2 are not fully compatible with figures in table 1; one cannot subtract federal welfare expenditures in table 1 from the totals in table 2 to obtain state and local expenditures. Parts of the federal budgets are spent by state and local governments. Also, the figures are from different sources.

TABLE 2

SOCIAL WELFARE EXPENDITURES, SELECTED YEARS, 1950–1977

YEAR	Total Social Welfare Expenditures (in billions of current dollars)	Total Social Welfare Expenditures (in billions of 1977 dollars)	Per Capita Social Welfare Expenditures (in 1977 dollars)	Social Welfare Expenditures (as percent of total government expenditures)
1950	$ 23.4	$ 58.4	$ 380	37.4%
1955	32.5	70.8	424	32.7
1960	52.1	101.8	557	38.4
1965	76.9	139.9	711	42.2
1970	145.5	222.8	402	48.2
1975	289.3	328.4	1,516	57.9
1977	361.5	361.5	1,646	59.7

SOURCE: Alma McMillan, *Social Security Bulletin,* vol. 42, no. 6 (June 1979), tables 2 and 3, pp. 9–10.

more than fourfold in the 1950–77 period. That growth in welfare expenditures means that in 1977 government at all levels in the United States was spending a total of about $1,646 per man, woman, and child, which indicates the extent to which the government continues to shift the nation's resources about. Without question, much income was lost through administrative waste in the numerous welfare programs.

More revealing than the figures on welfare expenditures in current and constant dollars is the growth in welfare expenditures as a portion of government budgets. Before the 1930s, welfare expenditures were a trivial part of relatively small government outlays. In 1950, on the other hand, welfare expenditures were about 37 percent of total government budgets. In the ensuing twenty-seven years, welfare expenditures grew relative to other categories of government expenditures to where, in 1977, they accounted for nearly 60 percent of *all* government expenditures, including programs for defense, roads, and energy. Furthermore, in 1950 welfare expenditures represented just under 10 percent of national income; by 1977 they represented almost 24 percent of the national income. In summary, one in every four dollars earned by someone in the country in 1977 was, in one way or another, channeled through the "welfare state."

From the figures that have been presented, one might get the impression that the welfare state has heaped benefits on the poor.

TABLE 3

NUMBER OF PEOPLE BELOW OFFICIAL POVERTY LEVEL AND FEDERAL OUTLAYS BENEFITING POOR, 1964, 1969, AND 1974

	(1) Number of people below poverty level (millions)	(2) Federal outlays benefiting poor (billions of dollars)	Federal poverty outlays per poor person = (2) ÷ (1)	
			Current dollars	1974 dollars
1964	34.1	$ 7.9	$ 232	$ 368
1969	24.1	15.9	660	888
1974	24.3	29.0	1,193	1,193

SOURCES: (1) *United States Statistical Abstract,* various years. (2) Edgar K. Browning and Jacquelene M. Browning, *Public Finance and the Price System* (New York: Macmillan Co., 1979), p. 200; as found in United States Department of Health, Education and Welfare, Office of the Assistant Secretary for Planning and Evaluation Office of Program Systems, "Federal Outlays Benefiting the Poor–Summary Tables" (March 1974), table 1.

NOTE: The number of poor persons in 1974 is distorted upward by the recession of that year.

Such an impression is grossly distorted. Billions of dollars have been spent to help the poor, but as shown in table 3 federal outlays benefiting the poor remain a small portion, less than 25 percent, of total federal welfare expenditures. Federal outlays benefiting the officially classified "poor" were a little less than $8 billion in 1964 and only $29 billion in 1974. Clearly, the welfare state is not intended, in the main, to help the poor, not even the almost poor. Most of the welfare expenditures, about 75 percent of welfare budgets, are monies passed around among income groups above the officially defined poverty level. As the number of poor has declined, rather significantly (see table 3), and as welfare budgets have increased, rather substantially (see table 2), the growth in the welfare state has meant a dramatic increase in the number of people who are effectively on the welfare rolls. Even if we could believe, and we cannot, that welfare expenditures are intended to move purchasing power from the higher-income groups to the lower-income groups, the magnitude of the increase in social welfare expenditures indicates that, over time, higher and higher income groups, in absolute and relative terms, have become recipients of social welfare programs. Of course, not all social welfare outlays are intended to benefit the lower-income groups; some outlays – like higher education, some forms of medical outlays, veterans' programs, and housing – are intended to benefit the higher-income groups at the expense of the poor.

It should be noted that even the small portion of the welfare budget that is expended on the poor is enough to raise the average income of many poor people above the official poverty income level. A family of four, on average, received $4,772 worth of benefits in 1974. The official poverty level for that year was $5,038. Since many poor people earned some income, many actually took home more income than the official poverty level. Of course, many poor people earned little or nothing, and the benefits of poverty programs are not distributed equally among the poor; some poor families, therefore, received much more than the average benefits and the average total income, while others received much less than the average.

Sadly, the dollars spent on social welfare programs do not cover – nor are they intended to cover – the full extent of government efforts to engage in social engineering, that is, helping one group at the expense of another. The government intervenes in the market in a variety of ways, the net effect usually being to help one particular group. Minimum wage laws effectively increase the incomes of some workers – those who retain their jobs in the affected market – at the expense of people who lose their jobs and are forced to take work at lower wages. Tariffs blot out foreign competition, giving the protected industries opportunities to raise their prices and make more money. In their impact, the higher prices have much the same effect on consumer purchasing power as a direct tax increase on personal income. The greater incomes received by workers, owners, and suppliers of the protected industries are categorically the same as welfare transfers, such as checks distributed to low-income mothers with children. Incomes in the protected industries, like welfare checks, are greater than what could have been earned in a free market; they are the consequence of forced, involuntary shifts in purchasing power. Finally, we must note the variety of regulatory agencies and commissions – such as the ICC, FPC, FCC, FEA, and a host of licensing boards at the state and federal levels – whose basic function is to protect the "regulated" industries from competition. Although they often offset one another, the function of such agencies and commissions is to alter the flow of income in the country toward their regulated industries. Given the tariffs in effect in a wide variety of markets, the many regulatory agencies and commissions, and the number of people directly or in-directly dependent on government expenditures, it is safe to say that there are relatively few Americans who are not, in one way or another and to one extent or another, on the welfare dole.

The Impact of Government on the Distribution of Income

During the first half of this century, there was a marked trend toward greater equality in the distribution of earned and spendable income. This move toward equality was fostered in part, but not entirely, by the new social welfare programs of the 1930s.[2] However, since 1950 (when, it might be added, government efforts to change the distribution of income began to mushroom) the distribution of income has barely changed. The data in table 4 on the shares of the nation's income going to the lowest and highest quintiles of the population tend to bear this out.

The most widely reported figures on the distribution of income come from the Current Population Survey (CPS) undertaken by the Census Bureau. The CPS income measure includes salaries and wages, net income from self-employment, social security income, interest and dividends, net rental income, government cash transfers, private pensions, alimony, and regular gifts. Table 4 reveals that the share of income going to those families in the lowest quintile of the survey population changed from 5.1 percent in 1947 to 5.4 percent in 1974. The share of the income going to the lowest quintile of unrelated individuals changed significantly more, from 2.0 percent in 1947 to 4.1 percent in 1977. For families and individuals combined in the 1958-74 period (the span of years for which the data have been computed), the change in the relative share of income for the lowest quintile moved from 3.3 percent in 1958 to 3.8 percent in 1977. As shown in table 4, the movements in the share of income going to the highest quintile of the three groups—families, unrelated individuals, and families and unrelated individuals combined—have been downward but relatively small. However, the actual magnitude of the shifts in relative shares of income for the various groups depends critically on the years chosen for comparison. Still, the *trend* movements in the income shares of the highest and lowest (as well as all other) quintiles have been insignificant.

Other measures of income and calculated distributions of income tell basically the same story: The distribution of income has not

[2] Morgan Reynolds and Eugene Smolensky, "The Fading Effects of Government on Inequality," *Challenge*, July/August 1978, pp. 32-37.

TABLE 4

INCOME SHARES FOR LOWEST AND HIGHEST QUINTILES OF POPULATION, AVAILABLE YEARS 1947–1977

	Census Bureau Percent of CPS Income[1]					
	(A) Families		(B) Unrelated Individuals		(C) Families and Unrelated Individuals	
Year	Lowest Fifth	Highest Fifth	Lowest Fifth	Highest Fifth	Lowest Fifth	Highest Fifth
1947	5.0	43.0	2.0	56.6	3.5	45.5
1948	4.9	42.4	2.5	50.8	3.5	44.7
1950	4.5	42.7	2.3	50.3	3.1	44.9
1952	4.9	41.9	2.6	49.7	3.5	44.3
1956	5.0	41.0	2.6	51.6	3.4	43.5
1958	5.0	40.6	2.4	52.9	3.3	43.4
1961	4.7	42.2	2.2	52.8	3.1	44.9
1962	5.0	41.3	2.6	52.7	3.4	43.9
1964	5.1	41.2	2.5	53.2		
1970	5.4	40.9	3.3	50.7	3.6	44.1
1971	5.5	41.1	3.4	50.4		
1972	5.4	41.4	3.3	50.9	3.7	44.8
1974	5.5	41.0	4.2	48.3	3.8	44.4
1977	5.2	41.5	4.1	48.2	3.8	45.2

TABLE 4 (Continued)

	Radner-Hinrich[2] Percent of Family Personal Income		Reynolds-Smolensky[3] Predicted Percent of Adjusted Income (Post-Fisc)		Browning[4] Percent of Adjusted Family Income (Post-Fisc)		Census Bureau[5]
	Lowest Fifth	Highest Fifth	Lowest Fifth	Highest Fifth	Lowest Fifth	Highest Fifth	Gini Coefficient for CPI Income
1947	–	–	–	–	–	–	–
1948	–	–	–	–	–	–	–
1950	4.8	46.1	6.4	48.0	–	–	–
1952	–	–	–	–	8.1	36.7	–
1956	4.8	45.3	–	–	–	–	–
1958	–	–	–	–	–	–	.403
1961	4.6	45.5	6.4	49.0	–	–	.420
1962	–	–	–	–	8.8	35.4	.407
1964	4.2	45.5	–	–	–	–	.410
1970	4.6	44.9	6.7	50.6	–	–	.407
1971	4.8	44.6	–	–	–	–	.409
1972	–	–	–	–	11.7	32.8	.414
1974	–	–	–	–	–	–	.409
1977	–	–	–	–	–	–	–

SOURCES: (1) U.S. Bureau of the Census, *Current Population Report: Consumer Income*, series P-60, no. 118 (March 1979), table 13, pp. 44–48. (2) Daniel B. Radner and John C. Hinrich, "Size Distribution of Income in 1964, 1970, and 1971," *Survey of Current Business*, vol. 50, no. 10 (October 1974), table 10, p. 27. (3) Morgan Reynolds and Eugene Smolensky, *Public Expenditures, Taxes, and the Distribution of Income: The United States, 1950, 1961, 1970* (New York: Academic Press, 1977), table 5.4, p. 74. (4) Edgar K. Browning and Jacquelene M. Browning, *Public Finance and the Price System* (New York: Macmillan Co., 1979), table 7.7, p. 202, based on E. K. Browning, "The Trend Toward Equality in the Distribution of Net Income," *Southern Economic Journal*, July 1976. (5) Same as (1).

changed very much in the last two to three decades. In a study of the distribution of "family personal income," Daniel Radner and John Hinrich found that the lowest quintile of the population received just about the same share throughout the 1950–71 period.[3] Morgan Reynolds and Eugene Smolensky, after making a number of adjustments to the CPS income measure, found that the lowest quintile of households had 6.4 percent of net income in 1950 and virtually the same share, 6.7 percent, in 1970. They concluded that the data show that "when the benefits of all government expenditures were added to the labor and capital income of U.S. households and the burden of taxes subtracted, the overall distribution of income had not changed significantly between 1950 and 1970. To be sure, the distribution of income that included the effects of government budgets was significantly closer to equality than the distribution made up of just labor and capital income, but we could not detect any significant trend in the degree of inequality."[4] The Gini coefficient (also in table 4), which is an alternative means of measuring the equality or lack of equality in the distribution of income across all income groups, moved up and down during the 1958–74 period but was virtually the same at the end of the period (.409) as it was at the beginning (.403), indicating, again, almost no movement toward greater income equality.

Only one major study of the distribution of income in recent years contradicts the data that have been presented. It was done by Edgar Browning at the University of Virginia, and the results are reported in table 4.[5] Browning made five major adjustments to the CPS income measure for families: First, he included in the distribution of income an imputed value for in-kind government transfers. Second, he added an estimate of the potential earnings of all adults in the labor force. Third, he included an estimate of the costs of the education provided by all levels of government. Fourth, he computed the distribution of family income on a per capita basis, thereby adjusting for the observed reduction in the number of people in families, especially among the poor. Fifth, he deducted an estimate for the personal income and social security taxes people pay. After

[3]Daniel Radner and John Hinrich, "Size Distribution of Income in 1964, 1970 and 1971," *Survey of Current Business*, vol. 50, no. 10 (October 1974), table 10, p. 47.

[4]Morgan Reynolds and Eugene Smolensky, "The Fading Effects of Government in Inequality," p. 32. See also Morgan Reynolds and Eugene Smolensky, *Public Expenditures, Taxes, and the Distribution of Income: The United States, 1950, 1961, 1970* (New York: Academic Press, 1977), especially chap. 5.

[5]E. K. Browning, "The Trend Toward Equality in the Distribution of Net Income," *Southern Economic Journal* 43 (July 1976): 912–23.

making these additions and subtractions, Browning found that the lowest quintile received 8.1 percent of net income in 1952 and 11.7 percent in 1972, a 44 percent improvement in relative income share, a rather startling assessment given the findings of all of the other studies.

Has the distribution of income moved toward greater equality or has it not? This question has no simple answer. All measures of income are defective in one way or another. Adjustments that are made to measure incomes are often more or less arbitrary and rather crude. For example, when the goods and services given under welfare programs are not bought by their recipients in the market, it is difficult to place a dollar value on in-kind transfers. Also, it is difficult to say whether the reduction in the size of the family has lowered the standard of living of the poor or if it is a consequence of an improvement in their standard of living. Finally, when people are unemployed it is extremely arbitrary to specify a market value for their so-called leisure time. A detailed accounting of the pros and cons of particular adjustments to income made in individual studies would take this essay far afield.[6] Suffice it to say that at a conference of researchers working in the area of income distribution, the trend in the distribution of income, as revealed by Reynolds and Smolensky and by Browning, was critically evaluated, and "the consensus at the conference placed the 'true' trend between these two positions, but somewhat closer to Reynolds and Smolensky: although many biases have a large impact on the level of inequality [as measured by the CPS income], the net results of these biases on the trend were judged to be small."[7]

Over the past twenty-five years governments at all levels have inaugurated innumerable social welfare programs and have spent literally hundreds upon hundreds of billions of dollars in their quest for income redistribution. However, the record reveals that nothing seems to have happened: *Standard techniques for measuring income show that the distribution of income has not changed very much from what it would have been in the absence of government programs.*

[6]For an in-depth critique of these studies as well as of others, see Michael K. Taussig, "Trends in Inequality of Well-Offness in the United States since World War II," *a review paper presented at the Conference on the Trend in Income Inequality in* the United States held at the Institute for Research on Poverty, University of Wisconsin–Madison, October 29-30, 1976.

[7]Sheldon Danziger, "Conference Overview: Conceptual Issues, Data Issues, and Policy Implications," summary statement of the Conference on the Trend in Income Inequality in the United States held at the Institute for Research on Poverty, University of Wisconsin–Madison, October 29-30, 1976, pp. 98-99.

Why? Is the answer simply that government is ineffectual, incompetent, impotent—unable to accomplish efficiently what it has set out to do? Is it that government never really had its heart in the pursuit of its ostensible objective? Is the answer that social welfare programs have ended up benefiting those who run them more than the poor themselves? Very possibly all of these answers have more than a grain of truth in them. However, other speculative answers can be offered. As Reynolds and Smolensky have pointed out, attempts to redistribute income met initially with some success, but over the last two decades several discernible changes have occurred:

First, the expansion of welfare programs, especially social security, has meant that the programs' coverage has expanded. Although welfare programs may have begun with well-defined low-income groups in mind, they have ended with coverage for virtually the entire population. Consequently, the redistributional effect of the programs has eroded.

Second, workers, who must ultimately fund the welfare programs through taxation of their incomes, have learned over time to alter the form of their earnings from taxable income, such as wages and salaries, to nontaxable income, such as fringe benefits and leisure.

Third, recipients of the welfare programs have adjusted their own behavior. In light of the very high marginal tax rates implicit in social welfare programs, they have decided quite rationally to work less in order to secure more welfare benefits. On balance, their incomes may have risen by only a fraction of the dollar value of the welfare benefits.

Fourth, the welfare system has progressively reduced the efficiency of the U.S. economy. The result may have been that the improvement in the earned income share of the lower-income groups has been impaired.

Fifth, over the last fifty years the tax code has been gradually broadened to include lower and lower income groups. The first federal income tax in 1913 applied to the incomes of only the very high income groups. Now the tax code applies to just about everyone aside from the very low income groups. The result has been a reduction in the equalizing effects of the tax system. The social security tax on employer and employee income has been progressively raised, with disproportionately strong effect on the lower-income groups.

Sixth, in the past twenty years state and local government taxes and expenditures have risen relative to federal taxes and expenditures. Aside from education, social welfare programs make up a relatively small part of the expenditures of state and local governments. Hence, growth in government at the state and local levels has tended to offset the redistributional effects of federal welfare programs designed specifically to help the poor.

Theories of Income Redistribution

Proponents of income redistribution have developed a number of theories intended to justify governmentally induced shifts in the nation's income. Several of the more prominent theories are evaluated in this section. The general conclusion drawn is that income redistribution by government has a very spongy, if not nonexistent, theoretical foundation.

Redistribution as Social Welfare Maximization

One of the oldest arguments used to rationalize income redistribution relates to a misunderstanding and misapplication of the principle of diminishing marginal utility in consumption. Stated properly, that principle says that as a person consumes additional units of a good, there is some point beyond which the relative marginal utility of each additional unit consumed will begin to diminish. In the nineteenth and early twentieth centuries the principle was taken to mean that beyond some point in consumption the *absolute* marginal utility of consuming additional units of a good begins to diminish. Indeed, it was readily, but incorrectly, assumed by many economists that marginal utility in consumption diminished from the very first unit. Social reformers concluded that aggregate social welfare could be enhanced by redistributing the nation's income from the rich to the poor. It was thought that the marginal utility of the last units of goods consumed by the rich was, by the very fact that they consumed more, lower than the marginal utility of the last units consumed by the poor. Hence, redistribution increased the total "utils" of satisfaction in society. How forced redistribution satisfied the Pareto principle for economic efficiency is not clear.

This justification for redistribution has been severely criticized on almost all grounds. First, it is conceptually impossible to make *interpersonal utility comparisons.* (We would not know a unit of satisfaction if we saw it, much less be able to say how different people value different goods!) Second, there is no real reason to believe that the marginal utility in consumption actually does diminish within the relevant range of consumption (that is, within realistic budget limitations). Third, the principle of diminishing marginal utility applies to the allocation of a *given* budget among a list of *specified* goods and services, not to the impact of changes in the budget level. For all we know, from a conceptual point of view the marginal utility of additional units of goods increases in absolute terms when more of *all* goods are consumed. If the principle of diminishing marginal utility has any use at all in consumption theory, it must relate to the change in the individual's *relative* marginal evaluation of goods when allocation decisions are made. There is no reason, therefore, to believe that the rich's *relative* evaluation of goods on the margin is any lower or higher than the poor's *relative* evaluation of those same goods, that the rich's marginal evaluation of income is any lower or higher than the poor's marginal evaluation of income, or that a shift in the distribution of income from the rich to the poor will necessarily increase social welfare.

The Rawlsian Theory of Justice[8]

Through the centuries philosophers have grappled with the question of whether there is a logical basis for ethical values. A primary concern of their struggle has been with developing principles that will enable people to decide whether or not a community's distribution of basic rights (such as the rights of free speech and the vote), wealth, and income are socially just or unjust; in other words, philosophers–economists included–have been in search of the broad theoretical outlines of the just society. In recent years Harvard philosopher John Rawls has organized what he calls "a theory of justice" that he believes incorporates the guiding principles people seek.[9] Rawls's theory is founded on several intuitively plausible postulates. First, in some endeavors people are better off acting cooperatively than they are acting alone. Second, there are a number of ways of organizing human interaction. Third, people must have some means or set of principles for judging and choosing from among the various potential social arrangements that arrangement which is "best." "These principles," according to Rawls, "are the principles of social justice: they provide a way of assigning rights and duties in the basic institution of society and they define the appropriate distribution of the benefits and burdens of social

[8]This section is a revised version of a discussion of Rawls's theory of justice found in Richard B. McKenzie and Gordon Tullock, *Modern Political Economy* (New York: McGraw-Hill, 1978), pp. 367–70.

[9]John Rawls, *A Theory of Justice* (Cambridge, Mass.: Harvard University Press, Belknap Press, 1971). For an excellent summary of this book, see John Rawls, "A Kantian Conception of Equality," *Cambridge Review*, February 1975, pp. 94–99.

cooperation."[10] (Examples of basic social institutions are the legal protections of freedom of thought and liberty of conscience, competitive markets, private ownership of the means of production, and the monogamous family.) Fourth, people are moral in the sense that they understand the need for and are prepared to affirm a conception of justice by which all social institutions can be judged.

In developing his theory of justice, Rawls is not interested in seeking and defining principles of justice that flow solely from the dictates of reason or science or that are derived from the teachings of a religion, although religious views may be a part of the process by which the guiding principles are derived. Rather, Rawls is interested in developing those principles that "free and rational persons concerned to further their own interests would accept in an initial position of equality as defining the fundamental terms of their association."[11] It is the acceptance of the principles of social justice by all people, however different their motives, that is the essential element of the Rawlsian theory. In taking this position Rawls recognizes, as James Buchanan has suggested, that "unless we are to be rescued by a 'savior' or 'saviors' who will enslave us all, modern men and women must reform their own institutions. Rules can be changed while the game continues to be played, but few players are willing to delegate decisions on such changes to the self-annointed witch doctors."[12]

With respect to changes in the distribution of income, the subject of this essay, Rawls seeks guiding principles that are not imposed upon, but emerge from, a social setting of people who recognize the need for general agreement: "The scheme of social cooperation must be stable: it must be more or less regularly complied with and its basic rules willingly acted upon; and when infractions occur, stabilizing forces should exist that prevent further violations and tend to restore the arrangement."[13] In short, without general agreement on basic rules, society may perpetually exist in a "Hobbesian jungle," a state of noncooperation in which all are worse off.

What are the basic principles of social justice on which people in general can agree? Rawls argues that they are principles that will emerge from a setting in which people choose jointly a social con-

[10]Rawls, *Justice*, p. 4.

[11]Ibid., p. 11.

[12]James M. Buchanan, "Notes on Justice in Contract" (Working Paper CE 76-6-4, Center for the Study of Public Choice, Virginia Polytechnic Institute and State University, Blacksburg, Virginia, 1976), p. 25.

[13]Rawls, *Justice*, p. 6.

tract that incorporates the principles of justice. In order for the principles to be "fair," the social-contract setting, according to Rawls, must be "fair" in the sense that no participant has an advantage in determining what those generally accepted principles of justice will be. If anyone has an advantage in determining the principles, the principles will be devised to correspond to the private interests of that individual and will lack the necessary general agreement that is so important in the Rawlsian theory for social stability. A "fair" contract setting is one into which all those who engage in social cooperation enter as equals. Further, they are all behind what Rawls calls "a veil of ignorance." Behind this veil "no one knows his place in society, his class position or social status, nor does any one know his fortune in the distribution of natural assets and abilities, his intelligence, strength, and the like, . . . [his] conception of the good or . . . [his] psychological propensities."[14] Without any knowledge of what their position in society will be, the participants are asked to devise rules for distributing basic rights in society and for distributing the society's benefits – the distribution of income. Rawls argues that two fundamental principles will emerge.

1. Each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others.

2. Social and economic inequalities are to be arranged so that they are both (a) reasonably expected to be to everyone's advantage, and (b) attached to positions and offices open to all.[15]

In the Rawlsian system of justice, inequalities in the distribution of wealth and income are just only when they are advantageous to everyone, especially the lower-income groups in society. Inequalities in the distribution are unjust when they are to the disadvantage of anyone, particularly to someone in the lower-income group. Rawls concludes that justice – a concept developed when people are in the initial contract state behind the veil of ignorance – requires that the income of the lower-income people in society be maximized. This is called the difference principle.

Many people who have read Rawls have concluded that the difference principle justifies a massive transfer of income from the rich to the poor because that is a redistribution scheme that even the rich would have accepted in the initial social-contract setting

[14]Ibid., p. 12.
[15]Ibid., p. 60.

behind the veil of ignorance. The difference principle, therefore, justifies present governmental poverty programs and expansions of them. On the surface, a redistribution from the rich to the poor does appear to be consistent with the difference principle; the income of the poor is apparently raised by the design of the program. However, the transfers can be inconsistent with the goal of maximizing the incomes of the poor. Massive governmental programs to redistribute income can reduce the incentive of the relatively rich to work and invest in productive assets. To the extent that the productive efforts of the rich are beneficial to the poor – to the extent that the poor work with capital equipment – a transfer of income from the rich to the poor can conceivably make the poor worse off, at least over a period of time, as the poor gradually have fewer capital assets to aid them in production. The poor of today may be better off because they receive supplements to their income that are transferred by the government from the rich. However, the poor of the future may be worse off because the aggregate income of the society then will tend to be less because of reduced capital accumulation. In this event, the poor of the future will tend to earn less income (they are less productive because they have less capital to work with), and the government will have less income to transfer from the rich to the poor. Indeed, Robert Nozick, another Harvard philosophy professor, has written a book that contains a major attempt to counter Rawls's basic arguments.[16] A basic thesis of Nozick's work is that the rich, who may be rich because of greater natural or acquired talents and who are more productive, benefit the poor by providing them with mutually beneficial opportunities for trade at lower prices than would otherwise exist. It is certainly doubtful that the poor would be better off if the rich did not possess their greater productive skills.

Richard Wagner goes even further and contends that adoption of Rawls's framework for establishing justice in the distribution of income may result in fewer income transfers from the rich to the poor than we now have.[17] Behind the veil of ignorance, people do not know their relative income position; and in that state they will vote for income redistribution schemes that reflect their ignorance of their relative position and the fact that they have an equal chance of being in a high- or low-income bracket. When the veil of ignorance is lowered, however, they immediately become aware of

[16]Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974).

[17]Richard W. Wagner, "Politics, Bureaucracy, and Budgetary Choice: The Brookings Budget for 1974," *Journal of Money, Credit and Banking* 6 (August 1974): 367–83.

their station in life—their present and expected future income. Wagner argues that in a world in which people are aware of their relative income standing, people with above-average income will vote for less equalization than formerly; those with below-average income will vote for more governmental transfers and greater equalization in the income distribution.

Given the country's distribution of income, there are many more people who have incomes below the average than people who have incomes above the average because the relatively few people who have extremely high incomes pull the average income level upward to the point where more than 50 percent of the people have less than the average income. In the real world of practical politics, in which the veil of ignorance has been dropped and people know their relative position in the income distribution, Wagner argues that people will vote for more income transfer programs than they would adopt behind the veil of ignorance, where there is at least some possibility that they each will have an above-average income. Rawls's theory of justice is based on the supposition that once the principles of justice are accepted, people will adhere to them: They will not change the rules of the game once the veil of ignorance is dropped. In the real world of practical politics, however, this condition, too, may rarely hold, or it may hold only to a very limited extent and for a relatively short period of time. Wagner's suggestion is that by using Rawls's veil of ignorance as a frame of reference in establishing justice in the distribution of income, the present distribution of income, which includes significant governmental transfers, may be unjust in the sense that there is too much rather than too little in the way of income transfers from the rich to the poor.

Finally, it should be noted that the Rawlsian rationale for income redistribution does not necessarily imply that the poor in the United States would be, or should be, the recipients of large income transfers. The poor of this country are the relative rich of the world, and there is no inherent reason why the Rawlsian theory of justice should be applied only within the boundaries of the United States. Hence, if taken seriously, the Rawlsian theory suggests that income should be transferred from just about everyone in the United States to lower-income people in the rest of the world.

Although Rawls's theory provides a basis for thinking through the complex issues of justice in the distribution of income from a noneconomic point of reference, it adds little to our understanding of how much governmental aid should be given to the poor. The argument can, with appropriate blinders to counterarguments, be used to "justify" more or fewer income transfers.

Entitlements and Redistribution[18]

Philosopher Robert Nozick has developed an "entitlements theory of distributive justice" that has caused philosophers and economists alike to reexamine the morality of taxation.[19] Succinctly, Nozick's theory justifies taxation only to the extent that the "minimal state," which is limited to establishing and enforcing property rights, is maintained. Taxation beyond that level can be construed as theft simply because it involves the type of coercion that a common thief exerts over his victim. Nozick writes:

> Taxation of earnings from labor is on a par with forced labor. Some persons find this claim obviously true; taking the earnings of *n* hours labor is like taking *n* hours for another's purpose. Others find the claim absurd. But even these, *if* they object to forced labor, would oppose forcing unemployed hippies to work for the benefit of the needy. And they would also object to forcing each person to work five extra hours each week for the benefit of the needy. But a system that takes five hours' wages in taxes does not seem to them like one that forces someone to work five hours, since it offers the person forced a wider range of choice in activities than does taxation in kind with the particular labor specified. . . . Furthermore, people envisage a system with something like a proportional tax on everything above the amount necessary for basic needs. Some think this does not force someone to work extra hours, since there is no fixed number of extra hours he is forced to work, and since he can avoid the tax entirely by earning only enough to cover his basic needs. . . . The fact that others intentionally intervene, in violation of a side constraint against aggression, to threaten force to limit the alternatives, in this case to paying taxes or (presumably the worse alternative) bare subsistence, makes the taxation system one of forced labor and distinguishes it from other cases of limited choices which are not forcings.[20]

Nozick goes on to point out the inevitable benefit that a person who likes leisure gains from an income tax system. A person who does not work because he likes leisure or likes the things that leisure time affords, does not earn a money income that is subject to taxation. He gets the benefits of nonwork but does not have to pay taxes on those benefits, simply because the benefits are in a nontaxable form – they are not money. On the other hand, the person who prefers goods – whether Shakespearean plays or suits of clothes – must give up leisure and the things that he can do with lei-

[18]This section is a revised version of a paper published by the author, "Entitlements and the Theft of Taxation," *Reason Papers*, Winter 1980.
[19]Robert Nozick, *Anarchy, State, and Utopia*.
[20]Ibid., p. 169.

sure time in order to earn the necessary money to buy goods; the money income that is earned is taxable, whereas the leisure, as noted, is not. The person who likes goods must either work longer, because of taxes, in order to obtain a given amount of goods or forgo some of the goods he planned to buy. Nozick adds:

> Given this, if it would be illegitimate for a tax system to seize some of a man's leisure (forced labor) for the purpose of serving the needy, how can it be legitimate for a tax system to seize some of a man's goods for that purpose? Why should we treat the man whose happiness requires certain material goods or services differently from the man whose preferences and desires make such goods unnecessary for his happiness? Why should the man who prefers seeing a movie (and who has to earn money for a ticket) be open to the required call to aid the needy, while the person who prefers looking at a sunset (and hence need earn no extra money) is not? Indeed, isn't it surprising that redistributionists choose to ignore the man whose pleasures are so easily attainable without extra labor, while adding yet another burden to the poor unfortunate who must work for his pleasures?[21]

To Nozick taxation is characteristically similar to theft because the implied coercion causes one person to gain at the expense of another in much the same way that a mugging causes the mugger to gain at the expense of the person who is mugged.

In an important counterargument, J. R. Kearl attempts to dispute Nozick's argument: "I will suggest in this essay that private rights over property, which are essential to the efficient use of resources in a price-market system of allocation, are socially defined. If one then accepts Nozick's rationalization of the minimal state and its monopoly position in 'protection,' the minimal state has a claim to social output. Moreover, this claim would allow it to engage in redistributive activities other than those necessary for maintaining the enforcement apparatus of the minimal state. Hence, taxation is not theft and limited redistribution is not immoral."[22]

With the use of the numerical example relating to a newly-discovered fishing grounds, Kearl makes what is now a standard argument that under common property rights (in contrast to private property rights), individual producers will ignore the external effects of their own fishing activities on the productivity of other fish-

[21] Ibid., p. 170.

[22] J. R. Kearl, "Do Entitlements Imply That Taxation Is Theft?" *Philosophy and Public Affairs,* Fall 1977, p. 76. For additional comments, see also J. S. Coleman, "Rawls, Nozick and Educational Equality," *The Public Interest,* Spring 1976, pp. 121–28. Kearl's basic argument is also made in less detail by Kenneth J. Arrow in "A Case for Redistributing Income," *New Republic,* November 2, 1974, pp. 24–25.

ermen: Individual fishermen will not consider the cost that they impose on each other and will therefore tend to "overproduce." When a fisherman goes out to fish in the "common fishing grounds," he must consider his expenses in labor and equipment in determining how long to fish and how many fish to catch. However, when the fishing grounds are common property, there is one cost that he is unlikely to consider, the increased difficulty that others will have in catching fish. Because some fish are caught, other fishermen will have more difficulty, incur greater costs, in catching their fish. In this way, the actions of any fisherman impose an *external cost* on others. If the individual fisherman had to incur the external cost, then he would catch fewer fish. Indeed, all fishermen would have higher cost structures, the price of fish would rise, and fewer fish would be caught and sold on the market.

When access to the fishing grounds is "free," as it is when the grounds are common property and when there are many fishermen, each individual fisherman will be unlikely to restrain his own fishing for two basic reasons. First, any one fisherman is unlikely to affect significantly the total quantity of fish on the market or the market price for fish. He simply isn't large enough when the group is large; therefore, there are no realized benefits to the *fisherman* for cutting back *his* production; the benefits are external, received by others who find fishing easier. Second, the individual fisherman can reason that if he cuts back his production, some other fisherman will probably come into the fishing grounds and take the fish that he does not take. If the stock of fish is being depleted by "overfishing," then the actions of the individual fisherman will not materially affect that outcome.

Furthermore, an individual fisherman is unlikely to do anything to contribute to the procreation of fish in the common grounds. If he does make any investment to increase the stock of fish, the cost of fishing to others will be reduced and others will tend to fish more, negating the "good intentions" of the individual who undertook the investment. From this line of reasoning, we can deduce that the common grounds will be "overfished" and nothing will be done by individual fishermen; all will tend to "free-ride" (or will attempt to "free-ride") on the efforts of others. If private rights (presumably, territorial rights) are assigned to individual fishermen, use of the fishing grounds will command a price, production will be reduced, and net social product will rise.

Kearl argues that because the collectivity must be involved in the assignment of rights or entitlements, the collectivity is productive and has a legitimate claim on the *increased* output of society: "We must acknowledge that a minimal state which does nothing more than define and protect private rights over property has a rightful claim to real output."[23] The state can, therefore, become more than "minimal" and remain moral; *it can take a part of the greater social* output from those who receive it and transfer it to those who are deemed in need or, perhaps, to those who may lose because of the initial assignment of private property rights.

Nozick and Kearl present sharply contrasting arguments on the morality of taxation. Taken in isolation, each argument seems to have a great deal of merit, partly because each does not deal directly with the issues the other raises. Nozick is concerned with the morality of the coercive power of government and how it is used in collecting taxes. However, Kearl points out a situation in which all parties can agree to distribute private property rights and to use some of the increase in social product to distribute to the "poor." Indeed, although Kearl does not do so, it can be pointed out that in order to get the agreement of the "poor" to the distribution of private property rights, those who get the rights and are "rich" may have to give up some of their income to the "poor" in the form of income grants or other welfare programs. The "rich" may not want to do that, but they may reason that they will be better off having private property and being "taxed" than giving up the private property with its greater income.[24]

Kearl's argument, however, has severe weaknesses. Although the contractarian perspective Kearl employs is useful to gain insight about the moral merit of taxation, his argument is for several reasons open to criticism. First, the argument assumes that property rights are defined and protected solely by the state. Hence, the implication is that the state has a significant claim on the social product, a claim that enables the state to expand beyond Nozick's minimum. That conclusion does not necessarily follow from Kearl's analysis. Property rights – i.e., socially recognized limits to individual and collective behavior – have frequently existed prior to formal government. Further, the property rights that have been recognized have been protected not by the state, but by individuals. Even when a state exists as an enforcer of property rights, those rights are only marginally protected by the state; they are overwhelmingly protected by individuals who have a private stake in

[23] Kearl, "Do Entitlements Imply That Taxation Is Theft?" p. 81.

[24] Geoffrey Brennen has argued that the rich may agree to some redistribution to ward off *violence or the threat of violence* by the poor to the rich and their property. See, "Pareto Desirable Redistribution: The Non-Altruistic Dimension," *Public Choice*, Spring 1973, pp. 43–68.

the retention of those rights. A person's "right" to his household furnishings, for example, is typically far more dependent upon his willingness to install locks on the doors and windows of his house than it is on the state's police force. As Stewart Macaulay argues, the courts are usually employed by contracting parties only in cases where there is an unresolvable breakdown in a contractual relationship. Most disputes are resolved privately.[25] Other studies reveal that a very high percentage of business contracts are actually unenforceable in the courts. The contracts have force, however, because of the parties' private interests in a continuation of their mutually beneficial relationships. Granted, the state may add to the security of property and may thereby, as Kearl argues, enhance the social product. However, if we are to follow the spirit of Kearl's argument we must conclude that the state has a claim on only the *marginal increase* in the social product that results from the state's *marginal contribution* to the definition and protection of property.

Looked at in this way, there is no reason to believe that the state's claim to the social product is sufficient to justify the state's expanding beyond Nozick's minimum. True, the claim may be sufficient for the state to engage in redistributive activity, but Kearl's argument does not really demonstrate that this is the case. Given the monopoly position the state has in the definition and protection of property rights, we cannot be sure that the state will operate efficiently in carrying out its basic function and that the state's legitimate claim to the social product, if there is one, will enable it to do more than protect basic rights.

Second, Kearl implicitly assumes that the state is an agent that exists prior to, and is independent of, the people who wish to have property rights defined and protected; he assumes the state holds the rights before the initial distribution and that the state, not the property owners, is therefore "entitled" to a fraction or all of the expansion of the social product that results from the definition and enforcement of property rights. However, if the state is viewed as an agent of the people who collectively agree, in a social-contract setting, to define and protect property, then it does not necessarily follow that the state is "entitled" to any claim on social product: The people who take the necessary steps to have property defined and protected – who set up the state – are the ones responsible for what the state does. One can reasonably argue, therefore, that the property owners themselves have full claim to the fruits of the property they own.

[25] Stewart Macaulay, "Elegant Models, Empirical Pictures, and the Complexities of Contract," *Law and Society Review*, Winter 1977, pp. 507-28.

Third, Kearl implicitly assumes that the state, as an independent agent, contracts with property owners for a portion or all of the increase in the social product that results from the state's definition and protection of property. There need not be any such contract. The state, as an independent agent, may act "out of the goodness of its heart," relinquishing all claim to the social product. If there were a contract, there would be no reason to believe that the contractual payments made to the state would be sufficient to allow the state to expand beyond Nozick's minimum. Indeed, Nozick seems to suggest that a social-contract conception of the state would and should hold the state to a minimal set of activities. If the state has a contract that gives it a claim to the social product, then property owners, even in Nozick's theory of justice, would have an obligation to make the payment. But, we must ask, where is the contract? The fact that the activities of the state are "productive," in the sense that they contribute to economic efficiency, does not, in and of itself, give the state entitlement to anything, much less a "rightful claim to real output" for purposes of income redistribution.

Fourth, Kearl implicitly assumes that taxation and the assignment of rights are separate and unrelated events. In organizing the criticisms presented here, assume, as does Kearl, that markets work reasonably well, if not perfectly, to reflect the value of the entitlements that have been granted. When markets work well, the value of the private property (or wealth) initially distributed will tend to be equal to the present value of the future income stream that can be received from the entitlements possessed. (People will simply base their bids for the property on how much income or benefits they can expect to receive from owning the property; at the limit in a competitive market people will bid prices that equal the expected value of the future income stream.) If, at the time of the initial distribution of property rights, the state gives clear notice of any plans to tax away a portion of the greater social output resulting from the assignment of rights, then no harm will be done: Redistributing future income will not be a problem. This is because the state has not fully distributed all the rights (or entitlements) that are available; it has not given people *full* claim to the existing fishing grounds, to use Kearl's example. The capitalized value of the rights that are distributed will reflect the claim of the state to the property's future income stream and will be less than it would have been in the absence of the state's claim or threat of taxation. What the state has not given, it cannot—overtly or covertly—take away.

Taxation may become, however, the practical equivalent of theft; it is certainly morally suspect when clear notice of the state's intentions is not given at the point of initial distribution of rights. For example, if at the time of the initial distribution the state does not assert its claim to the increase in social output and does not reveal its intentions to tax away a part of the increase in social output, then the state has effectively distributed all entitlements and has reserved nothing for itself. The capitalized value of the fishing grounds, or anything else subject to distribution, will reflect the full value of the rights that have been distributed: The capitalized value will be greater than it would have been in the case above in which the state asserts its residual claim.

As time goes by, the rights subject to the initial distribution will be traded for prices that approximate their capitalized values. If the state, at some future time, asserts a claim to the greater social product that results from the initial assignment of rights, then markets will adjust to what amounts to a redefinition and redistribution of rights. The market value of the assigned segments of, for example, the fishing grounds will fall, reflecting the lower net, after-tax income of the property. The people involved suffer a wealth loss: That which has been effectively given is taken away. Even if the people have adhered fully to the principle of justice in transfer, which they may have collectively accepted at the time of the initial distribution, the property is taken anyway, albeit covertly, in the market's reevaluation of the entitlements that remain. It is in this sense that taxation can take on characteristics of theft.

In addition to coercion, the act of theft can suggest total or partial deception or secrecy. If at the time of the initial distribution the state discloses its intentions to tax future income streams, either immediately or at some future point in time, then theft cannot be involved in taxation and no harm is done to future holders of the entitlements. Holders of property rights then know the full scope of the rights that they hold. The market price of the rights then reflects what the state discloses about its claim to future income. (The market price of the property will be lower the closer to the present the state plans to begin taxation.) People who buy property will pay only a price that reflects the present value of the future net, *after-tax* income stream. When taxation commences, entitlement holders will lose nothing in the way of wealth for which they have "justly" paid. The principle of justice in transfer will be fully operative.

The analysis in this section suggests that Kearl's argument is defective because it fails to account for the fact that future income streams are capitalized into the value of the rights that are subject to transfer. Furthermore, the analysis suggests that redistribution of wealth (from that which occurs at the time of initial distribution) can only occur when the intentions of the state to tax and redistribute income are, to one degree or another, kept secret. Taxation is objectionable to many simply because they prefer to keep that portion of the greater social output over which the state has an *announced* claim; the morality of state action is not *necessarily* at issue in such objections. However, taxation can become morally questionable and pejoratively equated with theft when the intentions of the state are not announced.

Furthermore, it should be understood, the state has reason, albeit weak, to hide its intentions to levy taxes. Taxes (other than lump-sum or perfectly general taxes), at levels that go beyond the function of the minimal state to provide protection of private property rights, dampen productive efforts and thereby keep the net social product from reaching the levels it would otherwise reach. This is one of Nozick's points. If the state assigns rights and at the same time announces its intentions to tax away a portion of the greater social product, then the social product, as Kearl suggests, can be greater than otherwise. The point suggested is that the social product will be even greater if the state's intentions to tax are kept secret. This is because the net marginal return to effort will be *perceived* to be greater than it actually is. When this happens, the state has not fully eliminated the problem of overproduction, which the assignment of private rights is intended to solve. Put bluntly, and less kindly, the state knows that by keeping its intentions to tax secret it will have more to steal.

Kearl concludes that "the state can, in fact, use its coercive apparatus to force some individuals to help others, since within the limits we have defined, it has been a contributor to the fruits of their labor."[26] The lesson of a "capitalized entitlements" approach to the question of taxation can be put succinctly: Although we may believe that governmentally defined and protected property rights contribute to economic efficiency, before we can comment on the morality of taxation we need to know more. We need to know exactly what rights are distributed initially and the taxation intentions (announced or unannounced) of the state.

Income Redistribution as a Public Good[27]

Poverty relief is said to be a public good: It benefits a large num-

[26]Kearl, "Do Entitlements Imply That Taxation Is Theft?" p. 81.

[27]This section is based on an argument developed by the author in detail in "A Note on the Construction of a Public Goods Demand Curve and the Theory of Income Redistribution," *Public Choice,* forthcoming.

ber of people more or less simultaneously, and the benefits of poverty relief, if relief is provided, are received by people who may not have contributed to the aid of the poor. In this regard, poverty relief is viewed by many people, including economists, as a legitimate government activity. Even Milton Friedman has recognized the public benefits that come from poverty relief and has justified some government redistribution programs on the grounds that private charities may generate less aid to the needy than is socially desirable: "I am distressed by the sight of poverty; I am benefited by its alleviation; but I am benefited equally whether I or someone else pays for its alleviation; the benefits of other people's charity therefore partly accrue to me. To put it differently, we might all of us be willing to contribute to the relief of poverty, *provided* everyone else did. We might not be willing to contribute the same amount without such assurance."[28] The usual presumption in such arguments is that collectivization of charity through redistributive programs will lead to more relief for the poor.

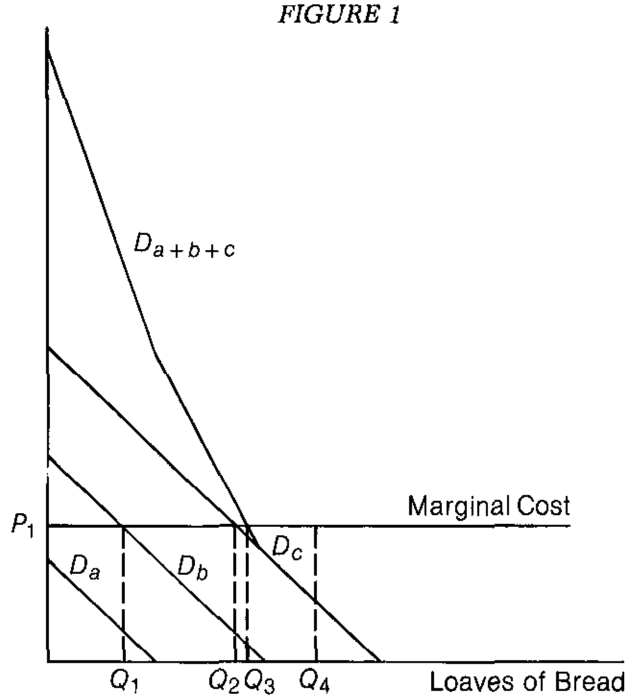
To see this argument (and its weaknesses) more clearly, consider figure 1. It contains the demand curves of three people, A, B, and C, for giving loaves of bread to the poor. Those who use this argument usually assume that everyone who has a demand for giving to the poor is aware of, and benefits from, gifts made by all the others. That is, if A gives a loaf of bread to the poor, then A and B are aware of the gift, benefit from A's gift, and adjust their own giving accordingly. Hence, the three demand curves, D_a, D_b, and D_c, are added vertically; and the resulting public goods demand curve D_{a+b+c} reflects the collective social value of each loaf of bread given to the poor: It indicates how much they are collectively willing to pay for any given quantity of bread that is given to the poor; alternatively, it indicates how much they are collectively willing to buy at any given price for a loaf of bread.[29]

If the three people in our model act independently of one another (as opposed to collectively), and if they are each aware of the aid going to the poor, they will provide less charity to the poor than is "socially desirable." To see why, suppose that the cost of providing loaves of bread to the poor is constant, meaning that the marginal cost curve of bread for the poor is horizontal and that each loaf of bread can be purchased for a price of P_1. At that price, and without

[28] Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), p. 191.

[29] For a more detailed discussion of the rationale for the construction of the public goods demand curve, see Richard B. McKenzie and Gordon Tullock, *Modern Political Economy*, chap. 3.

FIGURE 1

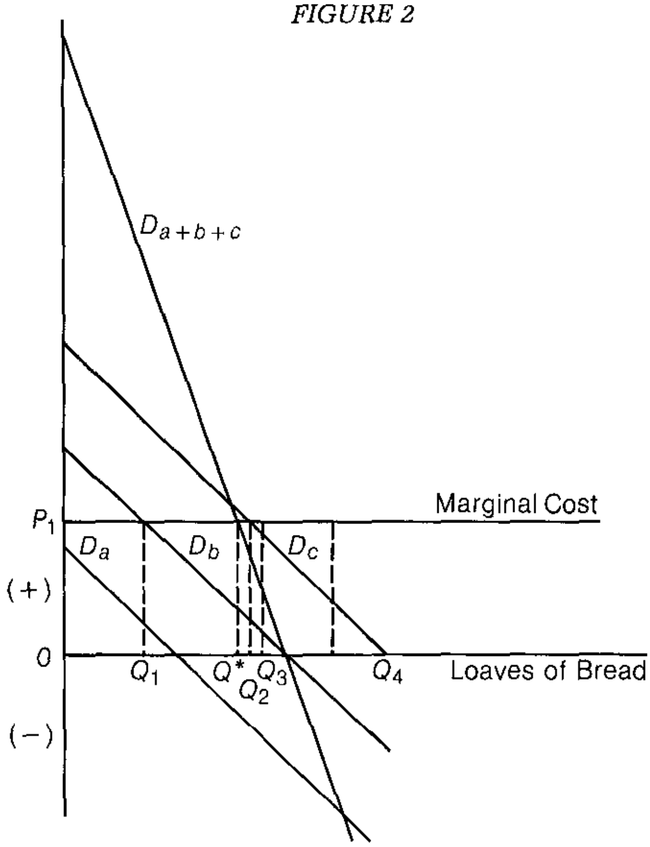


cost sharing, A will independently give nothing to the poor. The cost of giving the first loaf of bread to the poor is simply greater than the value A places on the first loaf given. How much B gives depends on what C does. If C has given nothing when B acts, then B will give up to the point that the price of bread is equal to the demand: He will give as much as Q_1. If B gives Q_1, C will extend the gift, giving up to the point that the price is equal to his, C's, demand curve. Therefore, C will give the difference between Q_2 and Q_1. The total amount given will be Q_2. On the other hand, if B has given nothing when C makes his gifts, C will provide all of Q_2 and B (and A) will "free-ride" on the charitable inclinations of C. Notice, however, that the three of them are collectively willing to give as much as Q_3, if the price of bread is P_1 and if the three of them can find a way to share the cost of the bread that is given to the poor. From this line of argument proponents of income redistribution conclude that private charity is "suboptimal" and that government can increase social welfare by providing charity through the tax and redistributive system.

The argument is seriously flawed. First, it might be noted that poverty relief is characteristically different from many other public goods, such as police protection and national defense. If police protection is provided in a community, most people can be aware of the amount of police protection that is provided. People can see the patrol cars when they go through their neighborhoods. However, much private charity is provided almost secretly, often in a manner so others in the community will not know of the charity that is given. Many charitable donors do not want others to know of their efforts to help the poor, and many recipients of charity do not want others to know that they have been helped by others. Consequently, to use our example in figure 1, A, B, and C may not know how much each has privately given to the poor. If each does not know what the others are doing, then private charity can result in "too much" charity, given the standard framework for analysis of public goods. In figure 1, if B and C do not know how much each has given to the poor, then B will give Q_1 and C will give Q_2, the summation of which is Q_4, an amount beyond the social optimum for poverty relief. The standard argument suggests that collectivization of charity will lead to an expansion of relief to the poor. However, we have shown that if people do not know how much is being given privately to the poor, then collectivization of charity *can* lead to a contraction of charity for the poor: The quantity of bread given to the poor will fall from Q_4 under private giving to Q_3 under governmentally organized welfare programs. In short, the public goods argument for government redistribution programs does not necessarily lead to the conclusion that government will or should increase the transfer of income over and above privately established levels.

Second, if taken seriously, the public goods argument for government poverty relief programs implies that people other than the truly poor may, in order to achieve the optimum relief level, be recipients of governmental transfers. In the development of the market demand for private, as opposed to public, goods an assumption conventionally made is that the demands of market participants lie entirely above the horizontal axis. In other words, it is implicitly assumed that all relevant units of the goods in question give positive utility to buyers. If one is dealing with private goods, this assumption is entirely reasonable. Production costs—and therefore prices for private goods—are positive, and no sane person will extend his consumption beyond the point that price equals the demand curve, much less the point that the demand curve touches or extends downward and beyond the horizontal axis: Units of any good that give people negative utility are simply not relevant when the benefits (positive or negative) are received exclusively by the buyers.

FIGURE 2



However, units of a public good affect, by definition, all people in the relevant group. The first few units of a public good may (but not necessarily will) give positive utility to all within the collectivity. If within the group there is considerable difference between demands of individuals, the collectivity can agree to provide a level of poverty relief that negatively affects some people in the community. It is easily observed that many people become very upset when government relief is given at some levels to some groups. In this regard, the conventional way in which public goods demand curves are derived (figure 1) is inaccurate.

Consider figure 2. *A*'s, *B*'s, and *C*'s demand curves in figure 1 are duplicated in this new graph. However, a major change is obvious: *A*'s and *B*'s demand curves have been extended into the negative quadrant, reflecting the implicit assumption that beyond some point the marginal value of an additional unit of poverty relief becomes negative for some people. Given these extensions, the construction of the public goods demand curve must be adjusted, as is done in the figure. The individual demand curves are still added vertically, but the slope of the public goods demand curve changes because of the negative values that are embedded in that portion of *A*'s and *B*'s demand curves below the horizontal axis. Given a marginal cost curve *MC*, the optimum output level is Q^*, the charity level at which the marginal cost curve and public goods demand curve intersect. Several points are worthy of special note. The new optimum charity level, Q^*, is less than the optimum charity level under the old construction in figure 1, Q_3. This new optimum charity level is actually less than the charity level that C would seek if he acted independently of the other two, meaning that collectivization of charity would lead to a reduction in the relief going to the poor. The important point, however, is that if advocates of public relief are consistent in the development of their conceptual framework and if there are people who attribute negative values to charity relief beyond some levels, as we suggest there are, then government must pay people whose demands are, within the relevant range of the social optimum, in the negative quadrant. Hence, as suggested above, the public goods argument leads to the conclusion that people other than the recipients of poverty relief programs can be, because of the existence of those relief programs, recipients of government transfers.

Third, the public goods argument for government redistribution programs becomes absurd when taken to its logical extreme. Government help for the poor is justified on the grounds that a large number of people want to see an improvement in the standard of living of the poor. The very same argument can be applied to large numbers of other groups, many of which may not be poor at all, and, indeed, the argument frequently has been applied to government aid programs for groups that are not poor. Agriculture programs are justified on the grounds that the concept of the family farm is an American tradition, a part of our culture and heritage, and should be preserved by government since virtually everyone benefits from the survival of the culture. Besides, so it is argued, virtually everyone is better off if farmers have a reasonably fair and stable level of income, which agriculture programs promote. Tariffs, special housing subsidies, and market-entry restrictions in professions have been justified, to one extent or another, by the "publicness" of the benefits received by the interest groups served by government. If we accept the public goods argument for poverty relief programs, it is difficult to argue against many other forms of government intervention in the market.

Concluding Comments

During the last decade or so, American society has gone through an almost unnoticed political metamorphosis. As Marc Plattner has poignantly observed, American society entered the 1960s as a "welfare state" and emerged in the late 1970s as, to a significant extent, a "redistributive society."[30] Plattner suggests that in the welfare state the poor may be aided through government programs; however, a common political assumption is that people who *own* their incomes pay a share of *their* income in the form of taxation to government for *common* expenses such as poverty relief. In the welfare state, people perceive themselves as handing over to a government a part of what is presumed to be *theirs*.

In the redistributive society, on the other hand, individual incomes are presumed to be a part of a common income pool. Plattner writes: "The redistributionist view, by contrast [to the welfare view], implies that the income obtained by individuals is not their own but that of the society as a whole. Hence, in assessing the rate of tax on an individual the government is deciding not on how much of his own income it will require him to pay, but how much of the society's income it will allow him to keep. And if it allows its more productive citizens to keep a more than equal share of the national income, this is only because the government has decided that allocating unequal shares will promote a more efficient and more productive national economy – not because the more productive citizen is in any way *entitled* to a larger income."[31] The redistributive view of society is clearly and cleverly presented in Arthur Okun's *Equality and Efficiency: The Big Tradeoff*.[32]

The redistributive view has two important implications that must be noted. First, as Plattner has argued, it undermines the moral basis of individualism: "The moral and political tradition that animates liberal democracy is founded on the notion that the rights of the individual are prior to the claims of the society – indeed, that the protection of those individual rights is the very goal of political society."[33] Many redistributive government programs cannot be explained or rationalized very well, as we have shown, by conventional economic analysis. A major reason is that the concept of jus-

[30] Marc F. Plattner, "The Welfare State v. the Redistributive Society," *The Public Interest*, Spring 1979, pp. 28-48.

[31] Plattner, "The Welfare State."

[32] Arthur M. Okun, *Equality and Efficiency: The Big Trade-off* (Washington: The Brookings Institution, 1975).

[33] Plattner, "The Welfare State," p. 45.

tice underlying traditional economic analysis is at odds with the concept of justice underlying many redistributive programs.

Second, the redistributive view of society makes the nation's income, to a significant extent, a common-access resource, as air, land, and water used to be. As tends to be true with all common-access resources, the competitive struggle for portions of this new common property should lead to abuse and misuse of the property. However, given the different perception of justice that underlies the redistributive society, the inefficiencies that result from the competitive struggle are of little or no concern to many redistributionists. For this reason, analysis of the kind presented in this paper will probably have little appeal for, or impact on, most modern redistributionists, who seem to have the upper hand in the development of long-term economic policy.