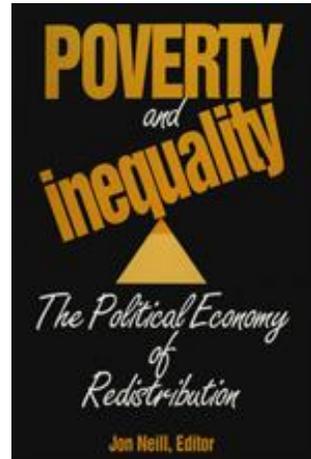

Upjohn Institute Press

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Chapter 7 (pp. 127-138) in:

Poverty and Inequality: The Political Economy of Redistribution

Jon Neill, ed.

Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1997

DOI: 10.17848/9780585314402.ch7

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This discussion is rather unusual in that I cannot remember the rather simple point made in it ever having appeared in the literature. This may indicate that I have been careless in my reading, so I hope that any of you who have seen it before will let me know.

That there is a tradeoff between redistribution of income and the total production of society and its rate of growth is believed by everyone, although there is little empirical evidence. Okun actually wrote a full book on this subject, coining the phrase: "the leaky bucket." One aspect of the tradeoff, however, seems to have been ignored. I shall begin my discussion of this point with a little example using numbers that I have simply drawn out of the air.

The reader will quickly realize that the importance of the phenomenon depends very heavily on these numbers. Thus, this example is intended as illustrative only. After I have presented the example, we will turn to discussing what effect different numbers would have, consider social mobility, and deal with risk aversion. This part of the chapter is, at least subjectively, original. In order to deal with some likely objections, at the end I will repeat some arguments I have used before on relative deprivation and international transfers, and then turn to a few remarks on charitable motivation.

Redistribution and Growth

Let us assume, then, that the United States government takes measures to supplement the income of the bottom 20 percent by an average of 50 percent, funding the transfer by an income tax on the upper 80 percent. Let us assume it does this in some reasonably efficient way without going into details. This should slow down the rate of growth at

least somewhat, and for purposes of this example I will assume the rate of growth falls from 5 percent a year to 3 percent.

As a result of this, the local GNP 15 years in the future will be enough smaller than it would have been had we not retarded growth by this scheme that the people in the bottom one-fifth of the population will receive lower incomes than they would have received had the transfer not been made.¹ Further, they will continue to receive lower incomes throughout all eternity with the differences steadily getting greater. The upper 80 percent were worse off from the word go unless they received enough satisfaction from helping the poor to compensate. In any event, they will be worse off even with the strong charitable motives after 15 years.

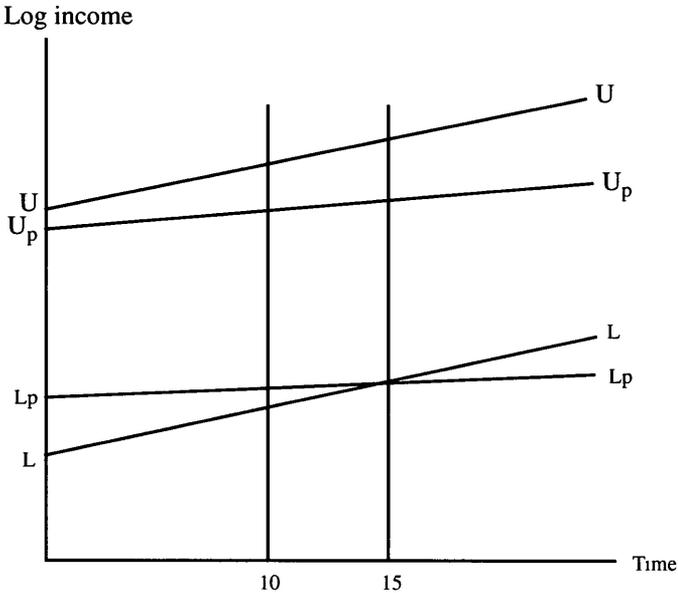
Figure 1 shows that situation. The line UU and the line LL are the income of the upper 80 percent, and the lower 20 percent without transfers. The line UP and the line LP are the post-transfer lines. The lines cross at 15 years for the poor, and UP is everywhere below UU for the well-off. The reality illustrated in this figure raises at least three questions, two regarding the purpose of the transfer scheme, the third a deep ethical question that economists tend to ignore.

The first question that we need to ask is whether this transfer has benefited the poor. Certainly this would depend upon a number of things, but most important the age of the poor person, his or her discount rate, and the effect of the transfer on the growth rate of his or her income. *Ceteris paribus*, young people would tend to regard the tradeoff as decidedly negative while poor people who happen to be the same age as the current ruler of China, Deng Hsiao-Ping, would think it a bargain. If poverty is primarily an affliction of the young and old, we have the house that redistribution is intended to benefit much divided. The public choice implications of this situation should be obvious.

The second question that comes to my mind relates to the intergenerational transfer resulting from any policy that reduces the growth rate. To look at it from the standpoint of all poor people (or the charitable well-off), the scheme would mean that in the future all poor people are poorer than they otherwise would be. On the other hand, with the economy growing anyway, people who are made poorer, i.e., the poor in the future, would nevertheless be better off than the people who are poor right now. Thus, it could be regarded as a transfer from the future

population—rich, poor, and middle-class—to the bottom 20 percent now.²

Figure 1. Income through Time



It is not obvious that this is undesirable. It is similar to the situation in which we deliberately retard investment now in order to raise current consumption with the full knowledge that the consumption in the future will be lowered, but will still be higher than it is now. However, this thinking seems only to be pertinent to affluent societies, since it is the reverse of the position taken by most development economists. What we frequently find in this literature is the recommendation that people should be compelled to increase their savings because the reduction in present consumption would be more than paid for by the increase in future consumption.³

This effect can be shown on the same diagram as we have given above. All that is necessary is to assume that the U_p and the L_p lines are the status quo with which we start before the transfer. The government then takes money from the poor and gives it to the well-off, thus

generating PP and the UU lines. This would effectively involve a tax on the poor.⁴ Of course, the development economists never actually proposed this kind of thing. They were simply going to put a general tax on the present generation and use it to subsidize capital accumulation, including human capital accumulation. Their idea was to cause higher growth. They normally talked about helping the poor, but as a matter of fact, most of the taxes were drawn from the poorest of the poor, the farmers, and the principal beneficiaries were civil servants and other government associates who are far from poor.

In any event, these programs have not worked but the basic reason is not that there was anything wrong with the theory. It was that actual implementation was very badly done. The famous bridge over the lower Congo connecting one dirt track with another dirt track is only one of many examples.⁵

Most economists would agree that this program of taking funds from the poor and giving them to the well-off would accelerate growth, and you will note that all of the arguments we have made before are reversed here. After a short period of time the poor would be better off. In this case, since the poor are better off in the future rather than now, transferring money from the present day poor who are very poor to the future poor who, although poor by the standards of the future, are better off, enhances the regressive-nature of the income transfer.

Some Ethical Questions

Redistributionists seem to think that they occupy the moral high ground. As I have said on other occasions, I am puzzled by the habit of discussing redistribution within a narrow geographical context. In most discussions of income redistribution, the really poor people in the world—people who live in places like Africa, India, and China—are left out. The homeless in Tucson are bad-off by American standards, but by the standards of India, they are rather well-off. They are certainly vastly better-off than the street people of Calcutta or the street children of Columbia. They are also in many dimensions better-off than their own ancestors were a few generations back. Their medical attention in particular is better than anything available until very recently.

In any event, the decision to lower the rate of growth in the United States by making income transfers will reduce the rate of growth in other countries. We are connected to them by international trade and, perhaps more important, by the trade in ideas, particularly the ideas for new or improved devices. When the production of these falls off, living standards will fall or perhaps simply not grow as rapidly in the rest of the world. This nexus can only make the rightness of redistribution more ambiguous.

The tendency of redistributionists to be much more concerned for the people of their own nation is an interesting phenomenon. Tucson is only 100 miles from the Mexican border, and a great deal of money is spent by the federal, state, and local governments in helping the poor in Tucson, most of whom even without that help would be better off than the average Mexican. All of them would be better off than the most impoverished Mexicans. To repeat, I find this curious, but most people I talk to find it quite natural. Presumably redistributionists have a willingness to trade off their personal welfare for that of others, and like all rational agents, are less interested in this tradeoff as its cost rises. That this preference should be given moral connotation is interesting, particularly if these preferences are dependent on the ethnic identity of the parties.

In any case, there are other ethical questions that redistribution raises. Let us return to our basic discussion of the transfer of funds from upper income to the lower. I do not think that in the real world a formal program with the announced objective of taking money from the poor to benefit the upper income as a way of getting faster growth will ever be adopted.

Turning to my example, it is not clear that the transfer is to the benefit of the people at the bottom. But, as the reader will no doubt have already noticed, it depends to a considerable extent on the exact numbers that I have chosen. Suppose that the effect on growth were less. As far as I know we have no clear-cut measures of the degree to which transfers reduce growth. Suppose for example, it would be not 15 but 150 years before the incomes of the bottom 20 percent would be as low or lower than they would be without the transfer.

The first thing to be said about this is that the out-of-pocket costs to the upper 80 percent would be exactly the same in the two different

examples, and transfers of this sort are normally urged in terms of the desirability of the upper class sacrificing for the lower.

Members of the lower class could all assume that they would be dead by the time the change occurred, and so they and other poor people would remain better off, indeed the children of the poor people, if they remained in the poorer class, would be better off. It would be the grandchildren and great grandchildren that would begin to suffer if families remained firmly fixed in poverty.

If we follow Barro and assume that people regarded their descendants as important as themselves, then the period of crossover would be irrelevant. The poor person would worry about his or her descendants in the year 3000 and would be opposed to the transfer. As far as I know no one except Barro actually believes that people behave that way. But if people do not, then on what moral authority do we transfer income from these future generations? Unlike the present generation of the wealthy, they have no democratic voice. They are entirely without representation, even though the burden of redistribution falls on them as surely as it falls on the present generation of wealthy citizens.

There are various numbers that would lead to the crossover point being somewhere between 15 and 150 and would lead to different attitudes on the part of the present poor. With present data we cannot say exactly how long the period would be. It seems to me that this provides an incentive for getting better numbers.

Social Mobility, Relative Deprivation, and Other Conundra

We now turn to social mobility and subsequently to aversion. I have implicitly assumed that people who are at the bottom 20 percent or in the top 80 percent will stay there, and that they expect their children to do likewise.⁶ This is not true in most societies, and certainly not in ours. The poor, in particular, tend to think that their children will do better in life than they themselves have done.

Circulation is to be expected, and we have an interesting asymmetry in the effects of this scheme. For the sake of illustration, assume that the average person in the bottom 20 percent believes that he will get out of it into the top 80 percent in 10 years. He will receive transfers

only for the first 10 years of the program. However, if the bottom 20 percent moves up, one quarter of the top 80 percent must move down.

For people presently in the bottom 20 percent, the expected benefit from the transfer is therefore reduced. On the other hand, the possibility of falling into the bottom 20 percent of the income distribution lessens the injury that the transfer inflicts on upper income people. Whether or not social mobility makes transfers more likely from a public choice perspective would depend on many factors.

Of course, the assumption of the change occurring at the end of 10 years is arbitrary, and also the assumption that the entire bottom group goes up. If we wanted to make a more precise argument here we would need a little algebra, but in the absence of any numbers to put in equations it doesn't seem worthwhile elaborating it. The general principles for these simple numerical examples would continue to apply.

This brings us to the topic of risk aversion. The reader, we hope, will remember that risk aversion, and the justification for income redistribution from upper income people to lower based on it was the major theme of chapter 13 in *The Calculus of Consent*.⁷ Since most people buy insurance at actuarially unfair prices, there is good reason to believe that most people are risk averse. Therefore, some kind of income insurance would be attractive to most people.

With risk aversion, even if everything we have said so far were true, we might get unanimous consent for an income redistribution scheme. It presumably would not be the kind of income redistribution we see in the United States, and other advanced countries in which you don't get help just because you are poor, but only if you are in certain appropriate categories. The bureaucratic difficulties, which mean you frequently don't get help at all until sometime after its need has become acute, would also be removed.

The first question is how much people are willing to pay for such insurance. The retarding of the growth rate of the income of the poor obviously makes it more expensive than in most traditional discussions. However, a lot of this would depend on where you made your decision. You might make decisions today in favor of redistributing to the poor which 200 years from now your descendants will bitterly regret. It would be true even of poor descendants.

There is a metaphysical problem. Since risk is something that most people avoid, reducing the risk is a positive service for society. Unfor-

tunately, it is not included in GNP, but for calculations such as we are making here we should at least mention the fact. It might be that the reduced growth rate shown in the figure is actually the growth with the service of risk reduction left out. It is not impossible, although I think it is unlikely, that the service of risk reduction, if included, could more than compensate for all the problems we have raised so far.

So far, I have merely discussed in a very vague way this particular problem. I think it would be thought of more, but it may be that it already has been thought of and carefully discussed in literature that I have not seen. To repeat, I hope any reader who knows of such literature will let me know. We will now turn to material that I know has been published before but that is needed to make this chapter even reasonably complete.

Let us turn now to relative deprivation, and here I will be repeating arguments I have made before.⁸ It is sometimes said that people are not interested particularly in their actual income but in their comparative income. An American living in Harlem is bothered more by the absence of a colored television which all the neighbors have than is a mother living in the Sahel when her child dies in a famine that takes the lives of many other children in her village.

You can see from my example that I regard it as basically an absurd proposition. I do not deny that to some extent it is true I can be jealous of people who are better off than I am, Harvard professors in particular. Indeed, I would think the fact that all the villagers are in danger of dying this way as a reason for increasing our worry about the matter rather than assuming that the parents don't mind.

To continue with my attack on the relative deprivation hypothesis, I usually refer to it as belief that if everybody has a toothache it doesn't really hurt. I should say that in my opinion this kind of feeling is predominantly an upper class one. We don't worry about starving, but we want to be respected by our acquaintances. This requires that our consumption be at least up to community standards. If we were really poor, such matters would be less important. Even if it becomes psychologically more important as we become wealthier, and the poor become better off, it is still a secondary effect. The people classified as poor in the United States have many privileges that Louis XIV would have liked.

Let us ignore the lesser cases, and invent a very extreme example. Consider Mr. Jones. He lives in Newport, Rhode Island in the 1890s, and his private yacht is only 100 feet long. None of the people he associates with have private yachts less than 200 feet long. The city fathers feel that this situation of relative deprivation cannot be tolerated. They put a tax on the wealthier people like J. Pierpont Morgan in order to supplement Mr. Jones' income so that he can have a yacht that is 150 feet long. The result of this is greater equality among the yachtsmen of Newport, but the rest of the world as a whole is somewhat worse off if these very highly paid and presumably productive people work less hard in reaction to the tax.⁹

It is hard to argue that this particular equalization of income is a good idea. I should say, however, that I have made this point in a number of lectures. Academia audiences normally showed signs of being unhappy, but did not otherwise respond. On one occasion, however, a professor did point out that in spite of the fact that poor people in the United States and the world were made worse off by this transfer of funds to Mr. Jones for a larger yacht, it might well have been true that the measured inequality of society would decline. This is true, but I have great difficulty believing anyone would support the policy for that reason.

There are, of course, reasons for the sort of behavior that I have been focusing on. Namely, a person may feel more strongly about the poverty of people who live nearby than about the poverty of those living far away. Tucsonites would therefore be more concerned about the poor of Tucson than the poor of Mexico, and no one would be for equalizing American and African incomes. Interestingly, this particular hypothesis would seem to imply that most poverty relief should be initiated at a local level. For instance, the City of Tucson should take care of its poor, with possibly the State of Arizona providing some assistance. But the federal government would be uninvolved in these programs.

It should be said that before the 1930s, aid to the poor was in fact administered locally. Liebergott's studies show that the poor did about as well relatively then as they do now. If people felt more strongly about the poor who are close, they would have done better. So to me, the situation remains a mystery.

A student of mine, studying income tax returns, came to the conclusion that the average American is willing to give about 5 percent of his income to the people who are worse off than he is. This is a rough figure and is only an average. Mother Cabrini gives more than 5 percent, and I am sure there are many people who give less. If you take the amount of money paid out by welfare states to the actual poor, let us define them as the bottom 10 percent, it usually turns out to be about 5 percent of GNP. This is not surprising as, after all, the people who make the private charitable gifts are actually the people who vote for government charitable gifts. So, we get the same outcome in both areas.

These data have led me to a rule of thumb, which is simply that people are willing to give away approximately 5 percent of their incomes for the aid of the poor and downtrodden. The whole thing is rather like dropping a stone into a bottomless pit. No one has ever complained about it. There are people who claim they give much more than 5 percent, but I am a little skeptical in most cases. Yet the fact that some people give more than 5 percent is not surprising. There are also people who seem to think that any government transfer even if it goes to millionaire farmers is somehow a charitable gift. Although no one ever objects to my generalization, I am impressed by the fact that it is rare anyone even comments on it. Further, with one exception, no one ever cites this particular point of view.¹⁰ Note, I am not saying that people refuse to believe. They never object to it. It is just something that is dropped into the memory hole.

If we move from the amount of money that people actually give away to what people say, they would appear to be much more charitable than they actually are. Thus, the American government is accused of being heartless because it doesn't give even more money to the poor. Frequently moralists accuse the whole society of being unduly selfish. It is noteworthy then that in the 1980s—supposedly the decade of indulgence, selfishness, and greed—private contributions to charity rose more rapidly than in any other recent decade. The people who decry the zeitgeist of selfishness never mention this.

I take a radically different attitude from most people. I observe people saying that they are more charitable than they actually are, and criticizing other people for not being more charitable than they actually are. The normal reaction is that we should all be nicer. My reaction is

different. I think we should simply admit that we are all charitable, but not very much so. Since we don't seem to be able to get these charitable contributions up above 5 percent, I would suggest that we simply admit this fact, and change what we say rather than what we do.

Economists normally think that what people do is a better measure of their preferences than what they say. Democratic governments are designed to give people what they want. By this is meant what they actually want, not what people say they want. I can think of all sorts of changes in the behavior of most groups which I think would be a good idea. We live in a democracy and democracies do what most people want, not what I want. I can vote like anyone else if I want to use it. Engaging in moral lectures on what people should want is a harmless activity, but it is also an unproductive one. Everyone is in favor of helping the poor, at least a little bit. However, there is little discussion of the theoretical problems surrounding income transfers. I hope that these realities regarding the motivation for and effect of redistribution would be carefully considered before any drastic antipoverty measures are taken.

NOTES

1. I am ignoring the point that was made by Browning and reinforced by other people that the transfer actually costs much more than the benefit. The reason is that it changes the behavior of both the victims and the people to whom it would be transferred. It is not that I regard this as wrong or unimportant, but it is not necessary for this discussion.

2. Plus the top 80 percent.

3. Probably the best presentation of this point of view was by Stephen Marglin, "The Social Rate of Discount and the Optimal Rate of Investment" in *Quarterly Journal of Economics*, February 1963, pp 95-111. This argument was replied to by me in "The Social Rate of Discount and the Optimal Rate of Investment. Comment" in *Quarterly Journal of Economics*, 1968, 58 (4), pp. 788-802. Marglin was also attacked by three other economists. In fact, I think you can say that intellectually it is perhaps the most thoroughly demolished idea in the literature. Nevertheless, the development economists held fast, and Marglin never formally changed position.

4. I trust the reader does not take this suggestion seriously enough so that I will be asked to explain what you do with those poor who literally die of starvation if they have to pay a tax. As a matter of fact, one could designate this a true negative income tax, not the fake negative income tax of the University of Chicago. In this case the tax you paid would be under a certain income proportional to the degree you fell short of that income, and if you are above that certain income you would receive a supplement proportional to the degree you are above. It must be admitted that this scheme deserves the title "Negative Income Tax" better than the more traditional usage.

5. This is famous because of the expense of the bridge. It should be said that like most World Bank projects it was well engineered. You can feel confident that the bridge will not fall down, which is not necessarily true of the work of many of the other aid agencies.

6. I follow the normal nationalistic assumptions and consider only Americans. Most people in the top 80 percent of most countries would be in the bottom 20 percent of ours.

7. James M. Buchanan and Gordon Tullock, *The Calculus of Consent. Logical Foundations of Constitutional Democracy*, Ann Arbor: University of Michigan Press, 1962, pp. 189-201.

8. *The Economics of Income Redistribution*, Dordrecht: Kluwer, 1983.

9. Few of the wealthy people at that time inherited their money.

10. Martin Paldam is that exception.