Wealth, Poverty, and Human Destiny

Doug Bandow and David L. Schindler, editors

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1

Creating and Distributing Wealth: Whose Responsibility?

Peter J. Hill

The issue of material inequality among people and the appropriate policy response to this reality is one of the most contentious in modern democratic societies. The debate focuses on government's role in reducing that inequality. One of the primary attractions of Marxist socialism was its promise of a more egalitarian society. Now that centrally planned, socialist economies have been found to be both inefficient and exploitative of their citizens, the debate has turned to inequality in market societies. An oft-expressed sentiment is that though markets are efficient, they are unjust, since market processes create significant economic inequality. Therefore, modern egalitarians argue, a legitimate role for government is to equalize the distribution of wealth or income in society.

In this chapter, I shall argue that the opposite is the case: government should not attempt, as an explicit policy, to redistribute income or wealth.[1] My argument has three components. First, the concern for material inequality represents a harmful distortion of an appropriate and laudable human motive, a desire to help the infirm, the suffering, and the unfortunate. Second, efforts to achieve justice through redistribution of income foster far greater injustices because of the inequality of political power that such redistribution requires. Third, redistribution as a policy goal involves structuring the rules of the game in such a manner as to inhibit the most important means of poverty amelioration available: wealth creation.

What should we care about?

Most religious and ethical systems, Christianity not least among them, express a level of concern for the poor in society. These belief systems outline a clear responsibility for those with material wealth to alleviate the suffering of the poor and even take as a measure of religious commitment the degree to which one helps the poor.[2] For instance, Proverbs 19:17 says, "He who is kind to the poor lends to the Lord" (NIV); in contrast, one "who oppresses the poor shows contempt for their maker" (Prov. 14:31). However, as legitimate and widespread as is this concern for the poor, addressing poverty by attempting to reduce inequality has serious shortcomings.

Discussions of inequality focus on the relative size of the economic pie held by particular groups. The percentage of income received by each quintile of the population is a common measure of inequality. For instance in the United States in 1997, the lowest 20 percent received 5.2 percent of the national income, the next 20 percent received 10.5 percent, the middle quintile 15.6 percent, the fourth 22.4 percent, and the highest 20 percent received 46.4 percent.[3] Income distribution in the United States is clearly not equal. Focusing on the relative size of the shares, however, tells us nothing about the well-being of the poor. All that we know from this data is the relative share each group receives from the total pie. We know nothing about the size of the pie, whether the bottom quintile is malnourished or not, what types of housing they have access to, what their life span is, whether they drink clean water or not, and what level of health care they can purchase.

Another measure that has a strong relationship to the quintile groupings is the Gini index, which varies between zero and one. An economy that has an index of zero is one with complete equality, while an index of one would represent complete inequality. The most

recent World Development Indicators from the World Bank list Gini indices that range from .231 (Austria) to .629 (Sierra Leone).[4] The Gini index is useful because it summarizes the income distribution data into a single number. As an indicator of economic well-being, however, it faces the same problem that the quintile shares measure does, in that it simply provides no information.

Egalitarians often quote the income distribution data and deplore any rise in inequality because of their inference that greater inequality means greater hardship for those in the bottom portion of the distribution. The fallacy driving this perception is the belief that world wealth is a zero-sum game. If there is a fixed amount of income or wealth in a society, then increases in inequality must indeed represent increases in hardship for some. But total wealth is not fixed. For instance, India has a Gini index score of .378, while the Gini for the United States is .408. The share of national income received by the lowest 10 percent in India is almost twice the share received by the lowest 10 percent in the United States (3.5 percent compared to 1.8 percent).[5] If one accepts the egalitarian assumption that greater income equality means a better world, one would assume that the poor in India are better off than the poor in the United States. But the fact that GDP per head in India is $460 compared to $34,260 in the U.S. indicates that the larger share of the pie received by the poor in India tells us little about their economic status relative to the poor in the United States.[6]

Even when income distribution becomes more unequal (the usual term used is "worsens," nomenclature that presupposes that an increase in income inequality is bad and that a decrease is good) within a particular economy, this change still provides no information on the well-being of those we ought to be concerned about, namely, the poorest sector of the population. Suppose that the income of the top 20 percent increased by 4 percent over a given period and the bottom 20 percent increased their income by 2 percent. Now contrast this situation with a situation in which the top 20 percent found their income decreasing by 4 percent and the bottom 20 percent experienced no change in their income level. By egalitarian standards, the second situation represents an improvement in the position of the poor relative to the first, for in the first case, income inequality would be increased. And yet in the first situation, unlike the second, the poor would now have access to better health care, higher nutritional levels, and better housing, surely things we ought to care about if we really are concerned about the well-being of the poor.

But, an egalitarian may respond, the poor measure their well-being with respect to other people, and if a society's income distribution becomes more equal, the poor feel they have improved their lot, even if their economic status in absolute terms has declined. It is true that individuals often measure their economic status with regard to the status of others, but that does not mean we should allow such comparisons to drive public policy. To do so capitulates to the base human tendency to envy what others possess. Policies that focus upon income equality legitimate envy. Rather than encourage people to rejoice when their fellow citizens do well, such policies encourage people to focus on resenting the achievements of others instead of celebrating their own achievements.[7] If some in a society find ways to create wealth, and if that wealth creation does not harm the well-being of others, why should those who have not shared fully in that wealth creation be resentful?[8] Envy and resentment will never be eliminated, but building public policy upon these most base of human motivations is a bad idea.

Focusing on material inequality creates several other problems. Most discussions of inequality have implicit assumptions about legitimate and illegitimate reasons for differences in income. Differences in effort and ability are often deemed to be valid reasons for the generation of differences in wealth, whereas luck, discrimination, and inheritance are seen as unfair or unjust reasons for the generation of such differences. However, two experiments indicate that substantial differences in income can be generated simply

through differences in people's willingness to work, in conjunction with minimal ability differences.[9] In Canada, an experiment gave men and women the opportunity to participate in something called the Cannabis Economy. (This experiment was designed to determine the effects of marijuana smoking on productivity.)[10] All of the participants were twenty to twenty-eight years old and all had twelve years of education or more. Subjects were not allowed to leave the experimental facilities, and they were provided with housing for the ninety-eight days of the experiment. They had the opportunity to weave woolen belts on small portable handlooms if they so desired, for which they received $2.50 per belt. The material was supplied free of charge, and they could work as many or as few hours as they wished. The subjects used their earnings to purchase food from the hospital cafeteria and the canteen. They could also take home any savings at the end of the experiment.

A second experiment occurred in the Central Islip State Hospital in New York. Chronic psychotics were given tokens for their performance of janitorial chores. The jobs were optional: the patients' basic needs of food, housing, and medical care were provided, so the tokens were only used to purchase additional consumption items. All participants had the requisite skills to perform the tasks.

In both economies the earnings of the highest group were over ten times those at the bottom. The Gini indices generated in these experimental "societies" were very similar to the indices of most Western economies. The conclusion of the researchers was that differences in abilities and willingness to work are sufficient to generate the income differences seen in the United States and other Western countries. When the effects of luck, original wealth position, and natural disasters were removed, there were still large variations in earnings. Although this does not answer the question of whether existing income distributions are legitimate or not, it does raise the issue of whether or not intervention to rectify existing distributions is actually an attempt to alter what could be called a "natural distribution," a distribution reflecting people's innate abilities and their desire for leisure or work.

What type of inequality?

Most advocates of government as an agency for the redistribution of income assume that this task can be carried out with few or no costs. Such is not the case. The achievement of greater economic equality can only come with the creation of great political inequality. Only when the coercive power of government is extended into numerous private spheres of action can substantial gains in material equality be realized.[11] In addition, the use of the term "redistribution of income" implies an original distributor. But such is not the case, either. In a free society, incomes result from the uncoerced interactions of individuals pursuing their own goals. They buy and sell products, transfer resources by gift, work for wages and salaries, and control most of their own lives. Since there is no original distributor of income, it is not possible to have redistribution unless some social agency becomes that distributor. Therefore, setting out to "redistribute" income requires a substantial alteration of institutional structures, an alteration that concentrates enough power in the hands of the coercive agency of government that choices are restricted. Robert Nozick has pointed out that to suggest income be redistributed is akin to arguing for the redistribution of marriage mates.[12] Since there is no one distributing marriage mates, it is difficult to see how one could redistribute them unless one replaced voluntary interaction with coercive, top-down direction. The same applies to income.

It is clear that all societies at all times generate substantial differences in income. The 2001 World Bank data quoted earlier indicate that some societies are more equal than others, but all societies have a degree of inequality. Even in Austria—the most egalitarian among the large number of countries for which data are reported—the bottom 20 percent of the income distribution receives only 10.4 percent of total national income, while the top 20 percent receives

33.3 percent. The experimental economies reported earlier show that in societies where fortune, inheritance, and access to means of production are equalized, the simple willingness to work will still generate quite unequal incomes. In other words, the diversity of humankind naturally reflects itself in material inequality, and thus efforts to reduce inequality require the use of substantial coercive power.

If individual rights are recognized and protected by government under the rule of law, economic inequality will result. Therefore, reducing inequality means moving away from the rule of law and stable property rights. Equality before the law, defined as the equal treatment of people in equal circumstances, is one of the great attainments of the modern liberal order. Reducing that equality to reduce material inequality is a costly project.

In the twentieth century, between 80 and 100 million people lost their lives at the hands of communist governments.[13] These deaths came not from defending borders against external aggression, but from attempts at social engineering in which the primary motivating force was radical egalitarianism. Stalin's elimination of the kulaks, Mao's Great Leap Forward and Cultural Revolution, and the killing fields of Cambodia represent the most egregious cases of attempts to achieve a socially sanctified objective through the coercive power of government. Equality before the law and recognition of individual rights were sacrificed to a higher goal: remaking society to meet a stated objective. While modern democracies do not use coercion in the brutal manner of these communist societies, it is important to remember that the desire to create greater equality has been a motive force behind some of the greatest tragedies of the twentieth century.

Some of the same problems that plagued the attempts of communist regimes to remake their societies according to a social ideal plague modern democracies in their attempts to redistribute income. A sufficient concentration of power to perform the "good" of redistribution can be captured and used for evil ends. Most egalitarians do not want *complete* equality, believing that some inequality occurs because of meritorious behavior or meritorious differences in individuals. But the information problems in determining merit are enormous. Much of what we call merit depends upon motive, and motive is difficult to ascertain. Is the physician earning $200,000 a year motivated by the desire to relieve suffering or is she concerned with her own well-being? What about food production? How much of it is carried out for laudable reasons and how much for selfish? It is beyond the capacity of government to obtain adequate information about meritorious behavior, and even if such information could be obtained, reaching any sort of consensus about the trade-offs between different forms of behavior and individual rights would be even more difficult.[14] Therefore, attempts to rectify material inequality will be arbitrary in nature and will seem quite unprincipled. Once the redistribution project is embarked upon, it is unlikely that the citizens of the redistributing society will find that the results meet even minimal standards of justice.

This is not to say that societal judgments about merit are inappropriate. The only question is, who should make them and how should rewards and punishments be meted out? Numerous institutions, ranging from families to churches to communities, need to make judgments about moral worthiness. Moral considerations are of crucial importance for a well-functioning society and moral judgments need to be enforced by societal pressure. But these numerous decentralized groups find it far easier to generate appropriate information about merit than does centralized government. Due to their different functions, they can measure merit along many different dimensions. And it is perhaps most important that these institutions do not have the power to use coercion to enforce their judgments, a limitation that prevents many injustices.

The use of government to enforce property rights and to protect against force and fraud does involve morality. Judgments must be made about what immoral behavior is and how it will be restricted. The information needed to keep people from invading other people's

lives, however, is far different than the information and social agreement required to determine the meritorious and nonmeritorious behavior that generates income differences. Government is not the appropriate repository for judgments about merit beyond the rule of law, which involves stable, predictable rules that apply to all citizens and include the enforcement of voluntary contracts and protection against aggression.[15]

Another important consideration is that equality before the law is an attainable objective. While not perfectly realized in modern societies, there are numerous historical cases of constitutional democracies that have done a good job of respecting the rights of individuals and maintaining equality before the law.[16] As I will detail in the next section, efforts to achieve greater material equality not only reduce equality before the law but also may be fundamentally unattainable. Therefore, it is tragic when government gives up a function that it can perform to try to achieve goals that are either impossible or come at great cost.

I have argued that rectifying material inequality can only be done through massive amounts of government power exercised unequally with regard to the members of a society. It is also the case that this exercise must be an ongoing phenomenon.[17] Assume that government intervention creates a desirable distribution of income at one point in time. If people are allowed to engage in voluntary transactions, there will be an immediate move away from this desirable distribution. People will pay premiums for the opportunity to watch certain athletic or artistic performances, they will seek to purchase scarce items in the marketplace, and even the satisfaction of nonmaterial human preferences will cause subsequent income differences. Therefore, state intervention to achieve a particular distribution must be a perpetual activity. The government must continually restrict human freedom and take resources from one group and transfer them to another group if the distribution is to meet the social objective of equality. Advocates of income redistribution through government must recognize that they are advocating a permanent and large presence of that government in the lives of its citizens.

It is not just restrictions on individual freedom and the reduction of equality before the law that result from efforts to achieve greater material equality. Other important social structures would suffer through attempts to achieve material equality. Choices within the family are a major cause of economic inequality. People pass wealth to family members. They teach and reinforce certain behavioral patterns and moral principles that, when worked out in the marketplace, have a substantial impact on incomes. They invest in the formation of human capital among family members through expenditures on education. Any attempts to alter the income distribution of a society must reduce the role of the family and lessen the ability of families to control their own resources. Between 75 and 80 percent of all income generated in the United States comes from human capital,[18] and a substantial portion of that capital reflects family teaching about work habits, job choice, and higher education. Only if the state assumes responsibility for many of these choices can economic inequality be lessened.

Caring for the poor

The general concern about material inequality is a perverted form of an important and justifiable moral concern: the material suffering of the poor.[19] Many of the problems of the poor come from unequal access to courts of law and an unwillingness on the part of the state to defend their rights to themselves and their physical property. When one looks at the gross injustices that have occurred throughout history, almost all of them would not have occurred had government performed its limited functions of maintaining equality before the law and protecting individual rights. Nevertheless, Christian doctrine, along with the teachings of many other religions, supports the premise that the better off have significant responsibilities to alleviate the suffering of the less fortunate. Since this moral obligation is clear, the only question is what is the best way to carry out this obligation.

Wealth creation is the most effective anti-poverty measure available. Starting around 1750, several Western societies sustained increases in income over time.[20] This increase in per-capita income represents a sharp break from historical trends and, in the context of those trends, is truly amazing. Real per-capita income has, on average, doubled every generation in the growing economies.[21] Thus, over the last 200 or more years, the process of wealth creation in Western economies has reduced the material impoverishment of millions of people.

By 1950, this trend of growth had reached one-third of the world's population, and since then it has reached many other parts of the world, especially Japan and East Asia, which have experienced sustained increases in per-capita income.[22] No conceivable amount of wealth redistribution could have reduced material suffering to the degree that economic growth and wealth creation have. Millions of people around the world have more to eat, better housing, more access to clean water, and better health care because of economic growth. A simple measure of the increase in economic well-being is captured in life expectancy statistics. It is important to note, therefore, that worldwide life expectancy has increased from twenty-seven years in 1600[23] to sixty-six now. Citizens of some of the more developed economies even have life expectancies that exceed seventy-five years.[24]

Economists have long sought to understand the reasons for economic growth and to explain the sharp differentials in economic well-being across different economies. Although numerous explanations have been tried and found wanting, recent work supports the hypothesis that institutional framework is the most important determinant of the degree of wealth creation within any given economy. One of the measures of the institutional environment has been provided by James Gwartney and Robert Lawson.[25] Their Economic Freedom Index measures the extent to which government operates under the rule of law (greater protection of property rights and access to a nondiscriminatory judiciary increases the freedom index) and the degree to which government intervenes in market transactions (a larger government, more regulation, higher tax rates, and restrictions on international trade lower the index).

The latest data available for the Economic Freedom Index are for 2000. In that year, the countries in the bottom quintile of economic freedom had a per-capita GDP of $2,256, while for the top quintile it was $23,450. Differences in growth rates are even more startling, with the bottom quintile showing an actual decrease in GDP per capita of 0.85 percent for the years 1990–2000, while the freest economies (the top quintile) grew at 2.56 percent annually during the same period. Other indices show similar results.[26] Thus there is strong evidence that increasing the well-being of the poor depends upon a structure of well-defined and enforced property rights, and a government that enforces the rule of law.

Some have criticized the use of this aggregate data as a measure of the well-being of the poor, since it does not provide direct evidence as to whether the poor have improved their situation or not. It is possible that the well-being of the rich has increased and thus raised national averages, even though the lot of the poor has not improved. The work of Seth W. Norton sheds light on this issue.[27] Norton tests the influence of institutional variables upon actual measures of the well-being of the poor. His primary measure is the Human Poverty Index (HPI), a measure developed by the United Nations that concentrates upon the most deprived people in a community. Rather than measure per-capita income, the HPI measures the degree of deprivation along several dimensions, including the number of people in the population not expected to survive to age forty, the proportion who are illiterate, the percentage without access to health services, the percentage without access to safe water, and the percentage of malnourished or underweight children under the age of five.

This measure has several advantages when one is determining the well-being of the poor. First, it does not depend on calculations of gross domestic product or gross domestic product per capita, data that may not capture fully the status of the least well off. Second, it

focuses on actual measures of human deprivation, which is the appropriate concern if one cares about the suffering of the poor. Norton examines the influence of different institutional measures of secure property rights and their influence upon the Human Poverty Index. His results are striking. The data concentrate just on the poor countries in the world, and in those countries, a move from weak property to strong property rights lowers the proportion of people not expected to live to forty from 25 percent to between 6 and 9 percent. Illiteracy drops from 43 percent to 13 percent and those without access to safe water from 35 percent to 6.5 percent when the measure of property rights moves from weak to strong. Similar data are reported for access to health services and the percentage of children under five who are malnourished.

The work reported above is only a small portion of the numerous research projects carried out in the last decade on the influence of institutions on well-being.[28] The overall conclusion is strong; if one wants to reduce poverty, it is necessary to have a strong but limited government that enforces the rule of law, freedom of contract, and private property rights. But this raises the important issue of the effect of efforts to achieve a more egalitarian society. Since such efforts require the substantial attenuation of property rights and the concentration of large amounts of coercive power in the hands of government, it is clear that these redistributive measures will result in lower levels of economic growth. Thus the misplaced focus on alleviating material inequality hampers the most effective means of poverty amelioration: the creation of wealth.

Other research supports this conclusion. James Gwartney, Randall Holcombe, and Robert Lawson examine the effect of government expenditures on the growth rates of the twenty-three OECD countries from 1960 to 1996.[29] Total government outlays as a percentage of GDP averaged 48 percent in 1996, an increase from 27 percent in 1960. Larger government, however, has meant slower growth. The authors estimate that economic growth is maximized when government outlays equal 15 percent of GDP. This means that efforts to redistribute income (and most of the expenditures above 15 percent have a redistribution rationale) have been expensive in terms of their reduction of income growth. The United States has had a more modest increase in the size of government than any of the other countries, going from 28.4 percent of GDP in 1960 to 34.6 percent in 1996. But even this increase has had a substantial negative impact on per-capita income. Had the U.S. maintained the size of government at its 1960 level rather than increasing it, real per-capita income would have been $5,860 higher by 1996. In other words, for an average household of four, family income would have been $23,440 higher.

Further evidence of government inappropriately using its power for purposes other than maintaining the rule of law comes from the work of Hernando de Soto[30] and the literature on rent seeking. The term "rent seeking" refers to efforts to achieve special favors through government, and the concept has been developed widely in the economic literature during the last several decades.[31] Rent seeking means that property rights are not secure from government expropriation since it is the transfer of property rights that rent seekers are asking the government to effect. There is much evidence that rent-seeking societies are both unfair and inefficient.[32]

De Soto has expanded the rent-seeking literature by looking at the property rights held by the poor. In his first book, *The Other Path* (1989), he argued that the informal economy, which dominates so much economic activity in poor countries, exists because of the substantial barriers to legal activity in these economies. As an experiment he and members of his research institute attempted to establish and register a small business in Peru. It took 289 days and $1,231 (thirty-one times the monthly minimum wage in Peru) to secure formal legal approval of their business. More recently, in *The Mystery of Capital* (2000), de Soto examined the legal barriers to establishing ownership rights to a home or land. In Egypt it takes six to eleven years to establish property rights to land, in the Philippines thirteen to twenty-five years, and in Haiti nineteen years.

De Soto argues that the biggest barrier for the poor to participation in economic growth and capturing the benefits therefrom is the lack of access to secure and stable property rights. He estimates that there is adequate capital (9.3 trillion dollars) for the poor in the form of their homes and land, but that this property is not available as collateral for loans since formal title is almost impossible to obtain. The exclusion from the formal sector imposes large costs on the poor because they cannot take advantage of many economies of scale in production, cannot benefit from specialization, and do not have access to modern technology and knowledge. Informality of enterprise and a lack of well-defined, enforced, and transferable rights mean the elite and politically astute have greater control over resources and capture most of the gains from rent seeking.

All of the above evidence leads to the conclusion that if one wants to help poor people, one needs to create the conditions that are conducive to wealth creation. Efforts to redistribute income change institutions in ways that hinder this wealth creation process.

A final important issue is the question of how redistributive programs work. As one thinks about democracy and the use of majority rule to determine political outcomes, it would seem that, once redistribution is a potential activity, some fraction of the top portion of the income distribution can form an effective coalition with those in the middle to prevent distribution to those at the bottom. They can do this by paying those in the middle some portion of what the redistributive take would have been from those at the top. It is unclear what the percentages and coalitions would be and the size of the transfer, but a rather straightforward prediction is that, once redistributive programs are put into place, they are likely to result in transfers from the well off to those in the middle rather than a transfer of resources from the rich to the poor.[33] The empirical evidence provides strong evidence for this argument.[34] Most programs that transfer resources in the United States are not means tested and result in massive movements of income from the rich to the middle class.

Another problem of using government to redistribute income comes from the difficulty of changing material well-being through coercive transfers. Transfers alter the incentives that individuals face and therefore alter the returns from engaging or not engaging in certain activities or behavior. Economics provides powerful evidence that people tend to equalize returns over time, which limits the ability of government to bestow benefits upon desired recipients. In the words of Gwartney, Stroup, and Sobel:

> In a world of scarce resources, government must establish a criterion for the receipt of transfers. If it did not do so, the transfer would outrun the government budget. Governments typically require transfer recipients to (a) own something (for example, land with an acreage allotment), (b) to do something (for example, fill out complicated forms, pass an exam, or make political contributions), or (c) be something (for example, unemployed or poor). Once the qualification criteria are established, people will incur costs seeking to meet it until the marginal costs of qualifying increase to the level of the marginal benefits of the transfer. Therefore, the beneficiary's *net* gain will nearly always be substantially less than the cost of supplying the transfers.[35]

Thus the use of government to redistribute income is unfortunate on several counts. Redistribution will slow down the process of wealth creation and slow down the increase in the material well-being of the poor. And wealth intended for redistribution to the poor will often be wasted through rent-seeking activities or will be usurped by other groups.

Conclusion

Using government as a vehicle for income redistribution is an idea that is flawed on several counts. First, it focuses on an inappropriate

measure of human well-being, namely, the relative size of shares of the economic pie rather than on the economic well-being of particular people or groups. Second, greater income equality can only be achieved by creating greater inequality in other areas, particularly in status before the law. Unfortunately, the poor and disadvantaged are the most likely to suffer when equality before the law is compromised. Finally, the most effective means of reducing poverty is through wealth creation, and most attempts at income redistribution hinder the wealth creation process. In short, government ought not to be engaged in redistributing income.