WHAT ECONOMICS CAN AND CANNOT SAY ABOUT EGALITARIAN REDISTRIBUTION

By Lawrence H. White

Abstract: *I critically consider four purported economic-efficiency arguments for egalitarian redistribution of income or wealth. (1) Jeremy Bentham's "greatest aggregate happiness" criterion has been used (by Bentham, John Stuart Mill, Alfred Marshall, A. C. Pigou, Abba Lerner, and more recently Richard Layard) to argue for wealth transfers toward the poor based on the supposition that they register higher happiness from a marginal dollar. Drawing from Vilfredo Pareto and Lionel Robbins, however, I argue that modern economic theory is not about individual happiness, let alone aggregate happiness, and therefore does not support (nor refute) any happiness-based case for wealth redistribution. (2) Theories based on a "social welfare function" misapply the economic way of thinking in a different way. (3) Other writers have framed redistribution as a public good, and public goods provision by the state as a voluntary collective means of satisfying individual preferences, thereby using modern economic theory to formulate a rationale for redistributive policies based on Pareto-efficiency. I criticize this rationale for resting on suppositions about actual preferences that are self-immunized against falsification. (4) James Buchanan made a related case for taxing inheritances based on the supposition that in constitutional deliberation behind a veil of ignorance we would agree to such a policy based on our preference for a certain kind of fairness. I find this argument non-economic, equally unfalsifiable, and no more plausible than alternative suppositions about our common preferences. The economic way of thinking does speak clearly, however, about how taxes on income or wealth discourage its production, the more so the higher the marginal tax rate.*

KEY WORDS: egalitarianism, redistribution, utility, Pareto efficiency, social welfare, preferences

I. Introduction

Proposals to redistribute income or wealth, which have long been debated by social philosophers and economists, have regained center stage in recent years. Thomas Piketty's best-selling *Capital in the Twenty-First Century* exemplifies what Michael Kinsley calls a "rising concern about income inequality" in today's public discourse. Kinsley considers it "evident that many people believe that a 'reset' in the distribution of income or wealth would be no bad thing." Proposals for egalitarian redistribution normally call for taxes on the richest households and transfers to the poorest in order to reduce the difference in living standards or to provide a minimum basic income. Piketty calls for raising the top-bracket income tax rate to 80 percent, and for adding a new global "progressive annual tax on individual wealth" with a top rate of 2 percent (or, he muses, perhaps as high as 10 percent). Unlike the authors that we will consider below,

doi:10.1017/S0265052517000036

however, Piketty apparently views it as desirable to lessen inequality per se by diminishing the largest fortunes, even if this provides no resources to the poorest.[1]

Programs for transferring resources to the relatively poor already exist, of course. Their magnitude may be of interest. By far the largest means-tested transfer program in the United States is Medicaid (including its recent extension: Children's Health Insurance Program, or CHIP). Federal and state Medicaid programs provided $489 billion in healthcare reimbursements to 68 million recipients (about 21 percent of the U.S. population) during fiscal year 2014. Other means-tested programs together provided an additional $230 billion.[2] The total of $719 billion was 4.1 percent of national income (GDP). If we assume that all beneficiaries of these other programs also received Medicaid, then all the programs combined provided an average of $10,574 per recipient ($719 billion total disbursements divided by 68 million people) in 2014. For comparison's sake, the official poverty threshold in 2014 was $12,071 for a single individual, $15,379 for a two-person household. Including administrative expenses, these programs cost $2,892 to the average non-recipient American. Many northern European nations have more extensive transfer programs. Theoretical arguments for egalitarian redistribution typically envision much greater transfers, and for unrestricted cash rather than the restricted-purpose funds of existing U.S. programs.

[1] Michael Kinsley, "The Improbable Dream," *Vanity Fair* (July 2014), http://www.vanityfair.com/news/business/2014/07/thomas-piketty-wealth-money-redistribution; Thomas Piketty, *Capital in the Twenty-First Century* (Cambridge, MA: Harvard University Press, 2014), 513, 517. Recognizing that income tax brackets as high as 80 percent typically raise little revenue (because they induce strong tax avoidance efforts), Piketty comments that "the primary goal [of imposing such rates] is obviously not to raise additional revenue." If so, it follows that the goal is not to transfer resources to the poorest. He explains: "It is rather to put an end to such incomes and large estates, which lawmakers have for one reason or another come to regard as socially unacceptable and economically unproductive" (p. 505).

For an analysis of the probable practical impact of Piketty's proposed taxes on the economy, see Michael Schyler, "What Would Piketty's 80 Percent Tax Rate Do to the US Economy?" Tax Foundation Special Report No. 221 (July 2014), http://taxfoundation.org/sites/taxfoundation.org/files/docs/SR221.pdf, and Schyler, "The Impact of Piketty's Wealth Tax on the Poor, the Rich, and the Middle Class," Tax Foundation Special Report No. 225 (October 2015), http://taxfoundation.org/sites/taxfoundation.org/files/docs/TaxFoundation_SR225.pdf.

[2] The Supplemental Nutrition Assistance Program ("food stamps") disbursed $70 billion to 47 million recipients; Supplemental Security Income, $54 billion to about 8 million recipients (calendar year 2014); Temporary Assistance to Needy Families, $32 billion; federal housing assistance programs, $50 billion; federal child care assistance, $9 billion (FY 2013, the most recent figure available); means-tested employment training programs (not already counted as part of TANF or SNAP), $15 billion. An older study of US transfer programs is provided by Robert Moffitt, ed., *Means-Tested Transfer Programs in the United States* (Chicago: University of Chicago Press for the National Bureau of Economic Research, 2003). The dollar figures come from the appropriate federal agency websites, except job training program expenditures from Burt S. Barnow and Jeffrey Smith, "Employment and Training Programs," NBER conference paper (29 September 2015), https://www.nber.org/chapters/c13490.pdf, 152, Table 8.7.

Here I critically consider a subset of the long-running debate over redistribution policies, namely a group of well-known arguments by philosophers and economists that claim the mantle of economic efficiency for redistributive policies. I will argue that such claims mischaracterize or dubiously apply economic theory. In particular, Benthamite utilitarians erroneously conflate their hedonic concept of "utility" with the non-hedonic utility concept of consumer preference theory in modern economics. Arguments that invoke a "social welfare function" abuse economic logic in a different way. The claim that egalitarian redistribution is a "public good," in the sense defined by economic theory, is by its nature a non-falsifiable claim. I also criticize a related argument for taxing inheritances offered by James Buchanan.

What the economic way of thinking *can* do is help us to identify the practical consequences of redistributive policies. It identifies the negative consequences of redistributive taxes for general economic prosperity, explaining why workers and investors who anticipate higher taxation of their income will choose to produce less taxable income.

In practice many current redistributive polices are non-egalitarian. Tariffs and business subsidies, for example, redistribute income from consumers and taxpayers to shareholders in protected or subsidized domestic firms, largely enriching the wealthy at the expense of the less wealthy. A large literature applies economic logic to the political economy of non-egalitarian transfer policies.[3] But these policies (which few openly defend, let alone defend on efficiency grounds) are not the subject here. I will also neglect the possibility raised by Robert Nozick that a public-choice logic might make transfers from rich to poor unsustainable as a democratic political equilibrium because the wealthy will outbid the poor for the support of middle-income voters.[4] Nozick's argument neglects the possibility that the rich prefer to raise the incomes of the poor, whereas assuming such a preference is the first step in the arguments that I will consider here.

II. The Benthamite Case for Wealth Redistribution

Jeremy Bentham famously proposed "the principle of utility," which holds that "the greatest happiness of the greatest number is the foundation of morals and legislation." That is, both private and government policies

[3] See for example Robert D. Plotnick and Richard F. Winters, "A Politico-Economic Theory of Income Redistribution," *American Political Science Review* 79, no. 2 (1985): 458–73; Avinash K. Dixit and John B. Londregan, "Redistributive Politics and Economic Efficiency," *American Political Science Review* 89, no. 4 (1995): 856–66; Gordon Tullock, *Economics of Income Redistribution*, 2nd ed. (Boston: Kluwer, 1997); and Daron Acemoglu and James A. Robinson, "Inefficient Redistribution," *American Political Science Review* 95, no. 3 (2001): 649–61. Tullock (p. 1) observes that "taking money from the rich and giving it to the poor" is "a comparatively small phenomenon if we compare [such] redistribution to the other transfers that modern government makes, not to the poor but to people who are politically well organized."

[4] Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974), 174–75.

should be judged solely or primarily by their effects on aggregate net happiness.[5] Many prominent subsequent economists including John Stuart Mill, Henry Sedgwick, Alfred Marshall, A. C. Pigou, and Abba Lerner have used this foundation to make a case for wealth redistribution by the state. As Pigou colorfully put the case, "the ninth course of the plutocrat's dinner . . . yields much less satisfaction on the whole than the milk which the cost of it might have secured for a poor man's child." Taking this proposition to its logical conclusion, Lerner famously provided a mathematical derivation of the proposition that, if the size of the income to be divided does not depend on how it is divided, then "the maximization of probable total satisfaction is attained by an equal distribution of income." Lerner concluded that "if it is desired to maximize the total satisfaction in a society, the rational procedure is to divide income on an equalitarian basis."[6] Lerner and others treat the Benthamite principle (when combined with what they consider reasonable auxiliary assumptions) as providing an *economic efficiency* rationale for government policies to redistribute wealth from rich to poor. Such treatments are in error, because the economic logic of choice is not about maximizing happiness or anything else that is interpersonally addable, and so *a fortiori* is not an exercise in applying Benthamite utilitarianism.

Lacking an actual method for measuring happiness,[7] Bentham could only assess the aggregate net happiness impact of any policy measure (including government policies to redistribute wealth from the rich to the poor) from his armchair, that is, by making assumptions and deriving their implications. Bentham made the (introspectively plausible) assumption of "diminishing marginal utility of wealth," meaning in this context that successive equal additions to an individual's wealth yield successively smaller additions to his or her happiness. An additional dollar of wealth adds less to an individual's happiness if he is rich than if the same individual is poor. In the absence of measurement it seems natural also to assume, as Bentham did, that any two individuals typically experience the same happiness from any given level of wealth (they have the same

[5] Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation* [1907; first ed. 1789], http://www.econlib.org/library/Bentham/bnthPML.html, ch. 1, para. VI. I discuss Bentham's views more broadly in Lawrence H. White, *The Clash of Economic Ideas* (Cambridge: Cambridge University Press, 2012), chap. 7.

[6] A. C. Pigou, *Economics in Practice* (London: Macmillan, 1935), 121–22; Abba P. Lerner, *The Economics of Control* (New York: Macmillan, 1941), 29, 32. Lerner wrote "probable" because he assumed that the assignment of marginal utilities of income across individuals has an unobservable stochastic element. For discussion of Lerner's argument see William Breit and William P. Culbertson, "Distributional Equality and Aggregate Utility: Comment," *American Economic Review* 60, no. 3 (1970): 435–44.

[7] Many researchers today regard questionnaires ("How happy are you on a scale from 1 to 6?") as an adequate way of measuring happiness. I leave this issue aside, and in what follows discuss utilitarian arguments on the assumption that happiness can in fact be measured.

"utility of wealth functions"). The combination of these two assumptions implies that a dollar given to *any* rich man will add less to his happiness, and thus to aggregate happiness, than the same dollar would add to the happiness of *any* poor man if given to him instead. It follows that to promote the greatest happiness, at least when the question is how a benevolent allocator should distribute manna from heaven, the allocator should always give manna to the poorest.

If we add as a third assumption that *taking* a dollar from a man with $X in wealth has the same quantitative effect on his happiness (with the opposite sign) as giving him a dollar when he has $X-1 to begin with, then it further follows that *aggregate happiness would be increased by a policy of taking wealth from the rich and transferring it to the poor* provided (a fourth assumption) that the transfer can be made with sufficiently small administrative costs, and provided (a fifth assumption) that such a policy does not have indirect effects (such as disincentives to wealth production) that reduce aggregate happiness more than the direct effect increases it.

Bentham himself rejected the third assumption (although many of his followers tacitly seem to accept it). He thought that everyday experience showed that a man loses much more happiness at having his money taken than he gains in happiness by receiving the gift of an equivalent sum.

Bentham also rejected the fifth assumption at some point before the last dollar of transfers sufficient to equalize wealth, on the grounds that complete leveling would severely discourage the production of wealth. If income or wealth taxes were kept to the minimum rate necessary to bring the extremely poor up to subsistence, he supposed, the direct happiness gain would exceed the direct and indirect losses. But he argued that complete leveling would so severely reduce total output as to reduce aggregate happiness. In small experimental societies where output is equally shared, he observed, too many become "idle cheats" who "cause themselves to be supported in their idleness by the dupes by whom they surround themselves; whilst the cry for equality is only a pretext to cover the robbery which idleness perpetrates upon industry," to the detriment of harmony, productivity, and general happiness.[8]

Bentham's arguments about negative incentive effects of income or wealth taxation use the economic way of thinking (see below). But his arguments about happiness do not. The modern economic theory of allocative choice is non-hedonic. To make this point is not to disparage Benthamite political philosophy any more than it is to disparage any other political philosophy. It is only to insist that economics does not derive from Benthamism, nor does Benthamism derive from economics.

[8] Jeremy Bentham, *Principles of the Civil Code*, in *The Works of Jeremy Bentham*, Vol. 1, published under the Superintendence of his Executor, John Bowring (Edinburgh: William Tait, 1843), chap. 11; http://oll.libertyfund.org/titles/2009 at #Bentham_0872-01_2217.

III. Economics, Happiness, and "Utility"

Many social scientists trained as economists have in recent years turned their attention to happiness research.[9] Some have unfortunately claimed more economic content for such research than is warranted. In a nutshell, the core of neoclassical microeconomics — as understood since Lionel Robbins (1932), who built on the work of Vilfredo Pareto — is a pure logic of allocative choice.[10] It has no more to say about happiness in the psychological or hedonic sense (the subject matter of the recent literature) than about love or nutrition, important as those things are. Robbins correctly noted that deriving the individual's demand curve or the market's demand curve, and thus price theory, does not require any reference to an individual's happiness, much less a measure of her happiness. The identification of choice-theoretic utility with happiness is therefore excluded by Occam's Razor. (Benthamism, by contrast, needs a measure of happiness that can be summed across individuals in order to quantitatively judge a law's impact on society's happiness in the aggregate.)

The consumer choice theory of microeconomics is about *preference*, not about experienced happiness. "I prefer x to y" is not synonymous with "x makes me happier than y." Unlike happiness, preference is not about how events make you *feel ex post*. Preference is instead about how you *rank* your perceived options *ex ante*. Thus, microeconomic theory does not speak in any direct way to the psychological or hedonic results of choices (although of course preferences may in many cases be based on anticipated hedonic results). For example, a person who voluntarily sacrifices leisure to earn more income reveals only that she prefers more income to that leisure, not that more income makes her feel happier.

To insist on the non-hedonic nature of microeconomics is not to *disparage* happiness research any more than it is to disparage any other research in psychology or sociology. It rather means being clear about the (limited and merely formal) relevance of economic theory to such research. It does mean, in the spirit of Robbins, denying the status of "based on economic reasoning" to policy prescriptions based on extra-economic postulates – in particular, the postulates of Benthamite utilitarianism. When Paul Samuelson writes about adding utilities across persons to arrive at total social utility,[11] he has ipso facto removed his economic-theorist hat and donned his utilitarian hat.

[9] For a prominent example see John F. Helliwell, Richard Layard, and Jeffrey D. Sachs, eds., *World Happiness Report 2015* (New York: Earth Institute, 2015).

[10] By "neoclassical microeconomics" I mean the orthodox post-1871 economics of individual consumers and firms interacting in markets. Excluded is classical or Marxian economics built on the labor theory of value.

[11] As quoted by David Schmidtz, *Elements of Justice* (Cambridge: Cambridge University Press, 2006), 146.

Robbins's point has been widely acknowledged. David Schmidtz is correct when he observes that "the concept of aggregated interpersonal utility used by Hare and Nagel" to argue on utilitarian grounds for egalitarian redistribution "has largely disappeared from economic discourse."[12]

However, although many economists nod to Robbins, some walk with Bentham and do not keep the distinction between the two approaches clear. Much confusion arises from ambiguous use of the term "utility." Bentham introduced his term as a *hedonic measure*, the balance of experienced pleasure over pain sensations, chosen or unchosen. Choice-theoretic utility, by contrast, is not a measure of experienced sensations, but rather an analytical construct for characterizing an individual's preferences in a choice situation. The earliest economists who developed the neoclassical (also known as marginalist or subjectivist) theory of consumer demand (Carl Menger, William Stanley Jevons, Leon Walras, and their early followers) unfortunately did not consistently recognize that such a personal preference-ranking indicator is distinct from a hedonic measure, and that the latter can be discarded.[13] Translators furthered the confusion between the two concepts in the early Anglophone literature when they identified the German-language economists' term *grenzwert* (the ordinal subjective value or preference-ranking a chooser assigns to an object's marginal use) with Bentham's hedonic term "marginal utility".[14]

There have been attempts over the years to change the economists' language. Vilfredo Pareto, one of the first to see that consumer demand theory requires only a preference ranking and not any hedonic measure, proposed unsuccessfully that economists should speak of "ophelimity" rather than utility. John Hicks and R. G. D. Allen successfully persuaded the profession to speak of "the marginal rate of substitution" between two goods (purely a ranking indicator) rather than of a good's "marginal utility," a term that lends itself to interpretation as the first derivative of hedonic "total utility." But economists continue today to call the algebraic representation of a preference ranking "the utility function." The contrast between the two types of "utility" was decisively clarified by Lionel Robbins in 1932. In an earlier article I suggested that we distinguish between

[12] Ibid. Schmidtz's references are to R. M. Hare, "Ethical Theory and Utilitarianism," in Amartya Sen and Bernard Williams, eds., *Utilitarianism and Beyond* (Cambridge: Cambridge University Press, 1982), 27; and Thomas Nagel, *Equality and Partiality* (New York: Oxford University Press, 1991), 63.

[13] For example William Stanley Jevons, *The Theory of Political Economy*, 3rd ed. (London: Macmillan, 1888), begins a chapter on "Theory of Utility" by declaring that "Pleasure and pain are undoubtedly the ultimate objects of the Calculus of Economics" (p. 37). This was a mistake in the now-standard Pareto-Robbins view.

[14] J. Huston McCulloch, "The Austrian Theory of the Marginal Use and of Ordinal Marginal Utility," *Zeitschrift für Nationalökomie* 37, nos. 3–4 (1977): 249–80; Jack High and Howard Bloch, "On the History or Ordinal Utility Theory: 1900–1932," *History of Political Economy* 21, no. 2 (1989): 351–65.

"Benthamite utility" and "choice-theoretic utility." More simply, we can call the first concept "happiness" and the second "preference."[15]

When "utility" is strictly interpreted as a preference indicator, the "utility function" of an individual is completely distinct from the happiness magnitudes required by Benthamite utilitarianism. Neither derives from the other. Robbins made the distinction in the following terms:

> But it is one thing to assume that scales can be drawn up showing the order in which an individual will prefer a series of alternatives, and to compare the arrangement of one such individual scale with another. It is quite a different thing to assume that behind such arrangements lie magnitudes which themselves can be compared. This is not an assumption which need anywhere be made in modern economic analysis, and it is an assumption which is of an entirely different kind from the assumption of individual scales of relative valuation.

I elaborated on Robbins's point as follows:

> None of this is meant to suggest that it never makes sense to speak of the pleasures afforded by goods, or of the magnitudes of those pleasures, or of the influence of anticipated magnitudes of pleasure on preferences. The point is rather that *choice-theoretic utility refers only to preferences themselves*, and not to any hedonic experiences or appraisals of anticipated experiences that might underlie preferences. (Nor, equally, does choice-theoretic utility refer to any ethical appraisals that might underlie preferences.) The utility theory of the modern economist is not concerned with hedonic, psychological, and ethical inputs into preferences, but instead "commence[s] from the colorless fact of preference" itself (Kirzner 1963, p. 57). [. . .] On the colorless view, choice-theoretic utility is not something experienced, or even an index of things experienced; it is an index assigned at a moment of choice.[16]

A recent example serves to illustrate the confusion possible when the term "utility" is used without a qualifier. The economist Tyler Cowen blogged about "the idea of redistributing wealth to take advantage of

[15] Vilfredo Pareto, *Manuale di Economia Politica* [1906], ed. Aldo Montesano, Alberto Zanni, and Luigino Bruni (Milan: EGEA – Università Bocconi Editore, 2006); J. R. Hicks and R. G. D. Allen, "A Reconsideration of the Theory of Value," Parts 1–2, *Economica* N. S. 1, nos. 1-2 (1934): 52–76, 196–219; Lawrence H. White, "Is There an Economics of Interpersonal Comparisons?" *Advances in Austrian Economics* 2, pt. A (1995): 138–46.

[16] Lionel Robbins, *The Nature and Significance of Economic Science* (London: Macmillan, 1932): 122; White, "Is There An Economics of Interpersonal Comparisons." The in-quote citation refers to Israel M. Kirzner, *Market Theory and the Price System* (Princeton, NJ: D. Van Nostrand, 1963).

differences in the marginal utility of money across varying wealth classes." Another economist, David R. Henderson, quickly objected that "you can't *measure differences* in the marginal utility of money across people." Cowen was presumably using "utility" in the sense of happiness, but he did not give an explicit indication of that, leaving Henderson to think that Cowen was making erroneous statements about "utility" in the microeconomic theory sense of preference.[17]

Economist Richard Layard of the LSE conflates the two concepts all by himself. He asserts that the empirical finding from happiness surveys that "among industrialized countries with incomes over $20,000 per head there is no relation between average income and average happiness" is "contrary to standard economic theory." He represents the "standard theory" as though the preference indicator of economic theory were a happiness measure. In his (ironically titled) Lionel Robbins lectures, Layard avers that "In the standard economic model, private actions and exchanges get us to a Pareto optimum where no one could be happier without someone else being less happy" and adds that "broadly speaking, the economic model says that the higher the real wage the happier the population." But these are misrepresentations of standard microeconomic theory.[18] The standard economic model does not define a Pareto Optimum by reference to happiness but rather to preferred positions — not the same thing. Standard economic theory assumes that more income is *preferred* to less, when it can be had without cost, but it does not say that the recipients of higher average incomes or real wages experience greater happiness.

IV. Willingness to Pay and the Kaldor-Hicks Criterion

As noted, the Pareto-Robbins insight that the logic of consumer choice theory is founded on ex ante preference rankings, and not on happiness

[17] Tyler Cowen, "The Differential Marginal Utility of Money," *Marginal Revolution* blog (May 20, 2015), http://marginalrevolution.com/marginalrevolution/2015/05/the-differential-marginal-utility-of-money.html; Henderson, David. 2015. "Tyler Cowen on Interpersonal Utility Comparisons," *Econlog* blog (May 20), http://econlog.econlib.org/archives/2015/05/tyler_cowen_on_14.html. In another recent example of confusion between happiness and the economist's choice-theoretic utility, commentator Ben Stein, insisting that he is faithful to his wife despite his reported involvement in sexting other women, wrote to a reporter that "The real issue, as Milton Friedman said often, is maintaining a positive utility function . . . I try to do that but often fail. My wife is the main contributor to my utility function." Hunter Walker, "Ben Stein Explains How A Woman Who Wanted To Stay At A Five-Star Hotel Got Him In A Fake 'Sexting Scandal'," *Business Insider* (July 3, 2014), http://www.businessinsider.com/ben-stein-woman-five-star-hotel-fake-sexting-scandal-2014-7.

[18] Richard Layard, "Happiness and Public Policy: A Challenge to the Profession," *The Economic Journal* 116 (March Richard): C25-C26; Layard, "Happiness: Has Social Science a Clue?" Lionel Robbins Memorial Lectures, London School of Economics (March 3–5, 2003), http://cep.lse.ac.uk/events/lectures/layard/RL030303.pdf, 13. To his credit, Layard does recognize (ibid., 2) that he is "taking a very different line from the one [Robbins] took on the subject of happiness." But he fails to acknowledge that Robbins's line is the standard line.

or any interpersonally comparable thing, has been widely acknowledged. From the foundational role of preference-ranking emerges the standard concept of economic efficiency: an allocation of goods is efficient (or Pareto-efficient, or Pareto-optimal) if there is no reallocation still available (such as a mutually beneficial trade of goods between J and K) that would move at least one party to a position he prefers (and move no party to a position she prefers less) to the starting point. In other words, no potential gains from trade remain uncaptured.

Correspondingly, the Pareto criterion for rating a trade an unambiguous improvement (a gain in efficiency) is that someone prefers to make the trade (there are winners) while nobody is moved to a dis-preferred position (there are no losers by the lights of their own preferences, including third parties). The Pareto criterion does not label a move an improvement if any person for any reason (it does not inquire whether envy, spite, or malice is at work) would prefer that the move not be made (meaning, would be willing to pay even a penny to stop it). Side payments from the winners out of their gains are a hypothetical way to buy off would-be objectors so that everybody prefers the package deal, but the offer of side-payments to objectors (absent a way to identify and rule out merely opportunistic objectors) invites ever more and higher-priced objections.

To limit the number of people with "veto power" over change, a modification of the Pareto criterion is sometimes suggested: a reallocation is said to be Pareto-improving if it benefits one or more parties J and K, and no party L is *harmed*, where what counts as harm is more than L's distaste. The 2015 Economics Nobel laureate Angus Deaton, for example, has suggested ruling out envy as a relevant harm:

> What about envy of the rich? Economists have a strong attachment to something called the Pareto principle . . . : If some people are made better off and no one is made worse off, the world is a better place. Envy should not be counted. The maxim is often cited as a reason to focus on poverty and not to worry about what is happening at the top. . . . There is nothing wrong with the Pareto principle, and we should not be concerned over others' good fortune if it brings no harm to us.[19]

The principle that Deaton offers here, that envy should not be counted as a harm, may be reasonable as a normative principle. But it is not the Pareto criterion, which refers only to preferences in judging whether a change is an unambiguous improvement.

Likewise, the Pareto criterion as such does not say that mutually agreeable trades are unambiguous improvements so long as they do not interfere with any third party's property rights. Thus, Robert Nozick's scenario in

[19] Angus Deaton, *The Great Escape* (Princeton, NJ: Princeton University Press, 2013), 207, 214.

which Wilt Chamberlain grows rich from mutually beneficial payments to watch him play basketball, where the payments lead from an egalitarian starting point to inequality of income and wealth, does not illustrate a Pareto improvement if some are moved to a less preferred position (would pay to reduce the inequality).[20] Normative disputes about the proper set of harms or rights to recognize are extrinsic to the Pareto criterion and to economic theory.

Equally, the Pareto-efficiency criterion provides no basis for considering it an improvement to take stuff from Peter to benefit Paul if Paul prefers not to have his stuff taken.[21] Pareto-improvement is about capturing gains from trade that are available starting from a given set of who owns what. Tax-financed transfer programs that proceed without the consent of every taxpayer change the initial pre-trade set of who owns what.[22] The Pareto criterion does not enable a ranking of two initial ownership sets.

The search for something more decisive than the Pareto criterion gave rise to the Kaldor-Hicks (KH) criterion, which takes a step back toward utilitarianism by reintroducing interpersonal aggregation in terms of dollars-worth of willingness-to-pay. A reallocation of goods is warranted if the gainers would be willing to pay more dollars to bring it about than the losers would pay to stop it. Unlike the requirement for a Pareto improvement, the gainers need not *actually* pay the losers enough to gain their consent. Aggregate dollar benefit-cost judgments replace unanimous consent. A reallocation is a Kaldor-Hicks improvement if on net it moves resources to uses valued more highly by bidders, that is, increases aggregate wealth, even if there are losers in the process. If Uber riders and drivers together gain more than taxi monopolies lose (and they must to the extent that taxis cannot compete on price because their costs are higher), allowing Uber to erode the taxi monopoly is a gain in KH-efficiency or aggregate wealth.

When it comes to evaluating wealth redistribution, the Kaldor-Hicks criterion has nothing positive to say because redistribution does nothing to increase aggregate wealth. Re-slicing the pie does not make for a bigger pie. By contrast to the Pareto criterion, the problem is not simply that there are losers, but that the gains do not exceed the losses. Having aggregate wealth as the thing to be maximized, rather than the aggregate happiness of Benthamite utilitarianism, makes all the difference. A rich man is willing to pay a dollar to keep a dollar, exactly what a poor man is willing to pay

[20] Nozick, *Anarchy, State, and Utopia*, 160–64.

[21] I have elsewhere noted that the Pareto efficiency criterion cannot even judge slavery to be inefficient relative to free labor, in the sense that *from the standpoint* of a slave-owning property rights system unilaterally freeing slaves is taking people's property, and the Pareto criterion by itself does not favor one set of property rights over another (Lawrence H. White, "Can Economics Rank Slavery Against Free Labor in Terms of Efficiency?" *Politics, Philosophy, and Economics* 7, no. 3 [2008]: 327–40).

[22] The public goods argument for redistribution, to be discussed below, considers the possibility of a redistributive program to which every taxpayer does consent.

to receive a dollar. No wealth is created by a transfer. Wealth maximization does, on the other hand, argue against a redistributive policy that dissipates any wealth (incurs administrative costs) in making transfers, or that has any disincentive effects on wealth creation. (Disincentive effects are discussed below.) If transfer costs are non-zero, or production-discouragement effects are not zero, redistributive transfers unambiguously reduce aggregate wealth and are inefficient by the Kaldor-Hicks criterion.

V. The Social Welfare Function

Another technique for achieving greater decisiveness in policy recommendations, pioneered by Abram Bergson, has been to simply ignore the Pareto-Robbins strictures and posit a "social welfare function" according to which a hypothetical social planner chooses to maximize some weighted aggregate of individual welfare scores.[23] Here "welfare" plays the role that happiness plays in Benthamite utilitarianism. Bergson himself characterized his approach as a formalization of what the utilitarians Marshall and Pigou had been arguing all along. The "utilitarian" aggregation scheme (all individual scores equally weighted) is only one of many possible social welfare functions.

Bergson-style analysis of social welfare uses part of the economic way of thinking, in that the social planner solves a constrained optimization problem. But it neglects the second defining characteristic of the microeconomic method, namely that economy-wide or social-level phenomena are built up from the interactions of decentralized actors. Microeconomics is characteristically about individual-agent-level optimization and market-level equilibration, not about social-level optimization. The social welfare function is supposed to represent "society's" preference function, but where individuals have different preference rankings there is not generally a non-arbitrary way to combine them into one coherent ranking.[24] In practice "social welfare" is simply *posited* to be a particular function of assignable individual welfare scores.

The social welfare function approach has dominated the "optimal taxation" literature since a 1971 article by James Mirrlees. As Diamond and Saez summarize the current literature:

> In general, optimal tax analyses maximize social welfare as a function of individual utilities — the sum of utilities in the utilitarian case. The marginal weight for a given person in the social welfare function measures the value [assigned by the function] of an additional dollar

[23] Abram Bergson, "A Reformulation of Certain Aspects of Welfare Economics," *Quarterly Journal of Economics* 52, no. 2 (1938): 310–334.

[24] See the very large literature on Kenneth Arrow's "Impossibility Theorem."

> of consumption [by that person] . . . . Such welfare weights depend on the level of redistribution and are decreasing with income whenever society values more equality of income. Therefore, optimal income tax theory is first a normative theory that shows how a social welfare objective combines with constraints arising from limits on resources and behavioral responses to taxation in order to derive specific tax policy recommendations.[25]

This is clearly not a Paretian but a social-planner or quasi-Benthamite use of the terms "utility," "welfare," and "optimal." Like Benthamism, optimal tax analysis posits a social maximization problem in which individual persons are regarded not as agents whose agreement is needed but as vessels of assigned point-scores. Deriving policy recommendations from an arbitrary function of individual scores — whether the score is called happiness or welfare, and irrespective of how the analyst stipulates that the "social welfare function" is weighted — has nothing to do with efficiency or optimality or utility as standard price theory uses the terms. Analysts who derive specific tax or redistribution recommendations by *beginning* from the statement that "society values more equality of income" per se[26] are evading the challenge of providing a compelling basis for such a valuation, such as deriving it from individuals' preferences as they empirically are in our society. Put another way, Diamond and Saez do not *make* "the case for a progressive tax" but simply *take it for granted* that policy-makers have accepted some such case and need advice on fine-tuning its application.

VI. What Economics *Can* Say: Production Disincentives from Redistribution

Jeremy Bentham, John Stuart Mill, and the later utilitarian economists Alfred Marshall and Arthur C. Pigou, all advocated redistribution, but only up to the hypothetical point where aggregate happiness maxes out. All recognized that taxing wealth to redistribute it would discourage wealth creation.[27] They considered the sensitivity of aggregate happiness to wealth transfers, and of production to tax rates, to be empirical questions. But all presumed that the aggregate happiness criterion calls

[25] J. A. Mirrlees, "An Exploration in the Theory of Optimum Income Taxation," *Review of Economic Studies* 38, no. 2 (1971): 175–208; Peter Diamond and Emmanuel Saez, "The Case for a Progressive Tax: From Basic Research to Policy Recommendations," *Journal of Economic Perspectives* 25, no. 4 (2011): 165–90.

[26] Rather than (say) "values a higher standard of living for the poorest, regardless of how much richer are the rich who came by their wealth honestly"; or, "has mixed views about the long-run net benefits of any tax and transfer program for reducing inequality of income."

[27] Some writers speak of income rather than wealth redistribution. The same arguments apply on both sides.

for *some* redistribution. Starting from the status quo, they judged that the first dollar transferred would surely increase the happiness of the recipient poor more than it would reduce the happiness of the taxed wealthy plus any happiness losses due to reduced total wealth. With additional transfers the marginal gains would shrink (because the poor are growing wealthier) and the losses grow (because the wealthy are growing poorer, and because wealth-discouragement effects are rising with higher tax rates). Losses would overtake gains before the point of complete wealth leveling was reached.

Like Bentham, Mill noted that the *complete* equalization of wealth would severely reduce the incentive to produce. The results of one's extra effort would go into the common pool and thereby (in any large society) go virtually entirely to strangers. The sharp disincentive to effort from such a policy would drastically reduce the aggregate amount of income available for distribution. Mill cautioned: "Society can subject the distribution of wealth to whatever rules it thinks best, but what practical results will flow from the operation of those rules, must be discovered, like any other physical or mental truths, by observation and reasoning."[28] The key practical result to be discovered was the exact extent of redistribution at which aggregate happiness was maximized and beyond which it began to decline.

Pigou did not offer a practical estimate, but asserted that the modern consensus among professional economists was that happiness-maximizing extent of redistribution was greater than economists used to think, by which he presumably meant to suggest that the government of his day should redistribute more:

> Here the State planner . . . must always be on his guard. He must not, in his eagerness to improve the distribution of income, so act as to dry up the sources from which it is produced. This is a very old problem. Economists to-day are, I think, agreed that taxes on the rich for the benefit of the poor can be pushed much farther than their predecessors supposed without serious damage to production.[29]

Supposing that the size of the social pie to be divided is not fixed, that wealth does not fall from the sky willy-nilly but must be produced by disagreeable human effort, neoclassical economics can and does, without requiring interpersonal comparisons or happiness measures, analyze the disincentive effects of wealth taxes or progressive income taxes on wealth creation. Mappings from wealth to happiness, as previously argued, are no part of economic reasoning.

[28] John Stuart Mill, *Principles of Political Economy: With Some of Their Applications to Social Philosophy*, 7th ed., William James Ashley, ed. (London: Longmans, Green and Co., 1909), 201.
[29] A. C. Pigou, *Economics in Practice* (London: Macmillan, 1935), 121–22.

There are two main locations of disincentive effects. The first is along the income-leisure tradeoff.[30] Where an individual faces a marginal choice between how much time and effort to spend generating income and how much to spend otherwise, the individual's personal optimum occurs where the income from additional work stops being preferred to the sacrificed leisure. A tax that reduces the share of the income that an individual gets to keep from the last hour worked shifts the tradeoff by lowering the sacrificed-income cost of leisure. It creates a disincentive to productive work, an incentive to choose less work effort (assuming that for hours or effort one does not expend on earning income, one gets to enjoy 100 percent of the leisure). Individuals facing such taxes will work less and produce a smaller pie.[31] They would have preferred a bigger pie and less leisure, if not for the tax.

The work-disincentive effect of income taxation might be considered unimportant if in practice the effect is so weak that higher marginal income tax rates reduce national income only negligibly. How strong is the effect empirically? Different empirical studies have estimated different magnitudes by taking different sets of indirect effects into account, employing different data samples, and using different estimation techniques. In a cross-country regression study that usefully isolates the effect we seek, Reinhard B. Koester and Roger C. Kormendi find that "a 10 percentage point decrease in marginal tax rates, holding average tax rates constant [so that there is no change in disposable income and thus no income effect], would increase per capita income by . . . approximately 13 percent of the median per capita income." When they divide the sample between low-income and high-income countries, the estimated effect is 15.2 percent of median per capita income in low-income countries and 7.4 percent in high-income countries.[32] Their results are not just statistically significant, but the size is economically important.

[30] Here "leisure" can stand for any non-monetary benefit that the individual trades off against higher income, such as greater intellectual stimulation or autonomy or lower stress on the job, or living in a more pleasant location. When different people choose different combinations of income and happiness from non-monetary sources, observed income is an unreliable proxy for happiness. (I am indebted to Todd Zywicki for discussion here.)

[31] Strictly speaking, the theoretical result follows for a tax on income from the marginal hour of work, while holding the individual's disposable income (or total tax burden) constant. For example, it holds when the marginal income tax rate is increased but other taxes are reduced to keep the average tax rate and thus disposable income constant. A higher marginal income tax rate *not* offset by tax reductions elsewhere reduces the individual's total disposable income, and it is possible that the taxed individual would then choose more work effort to return toward his original disposable income level. In other words, at a lower disposable income level the marginal preference for income over leisure is stronger. This "income effect" could in principle dominate the "substitution effect." But econometric evidence for the United States indicates that the substitution effect dominates the income effect in practice. That is, a higher tax rate reduces hours worked (especially for women, who more often work part-time) despite lowering disposable income.

[32] Reinhard B. Koester and Roger C. Kormendi. "Taxation, Aggregate Activity and Economic Growth: Cross Country Evidence on Some Supply-Side Hypotheses," *Economic Inquiry* 27, no. 3 (1989): 367–86.

The U.S. Census Bureau reports that 2015 median pretax household income in the United States was $ 56,500. A drop of 7.4 percent, due to the work-disincentive effects of higher marginal income tax rates, would be a loss of $4,181 per year per household.

The second margin where redistributive taxes reduce output is the consumption-investment tradeoff. In a multi-period world, where we consider an individual's choice between consuming more today or instead saving and investing more for the sake of consuming (or allowing heirs to consume) at future dates, a tax on income from saving or investment creates a disincentive to invest. (Here saving means consuming less than one's current income, which provides the resources for investment. Investment means the use of saved resources to build productive capacity.) Less saving and investment means less real capital formation, leaving workers in future periods with fewer tools or less training. Potential savers and investors who face higher such taxes will save and invest less, resulting in a smaller pie in every future period.[33] As David Schmidtz has noted, taxing and transferring wealth from rich to poor moves resources from those who tend to save a larger share of those resource to those who tend to save a smaller share.[34] It shrinks the supply of savings, reducing resources for capital formation, implying smaller pies in the future.

Eric Engen and Jonathan Skinner, surveying an array of empirical studies, provide an estimate of the effect of tax rates on the *growth rate* of the economy's aggregate output, assuming a 5 percent marginal tax rate change with some effect on the average tax rate:

> The implied effects from the "bottom-up" microlevel studies and the "top-down" cross-country regressions are quite close in magnitude: a major tax reform reducing all marginal rates by five percentage points and average tax rates by 2.5 percentage points is predicted to increase long-term growth rates by between 0.2 and 0.3 percentage points.

As they note, even such seemingly modest effects on the growth rate "can have an important long-term impact on living standards."[35] A tax structure with rates 5 percentage points higher, if it slows annual growth by the midpoint estimate of 0.25 percentage points per annum, after thirty years implies a 7.78 percent lower level of annual national income (GDP). The International Monetary Fund projects that the United States' GDP will be 19.377 trillion dollars in 2016, so that a 7.78 percent reduction would be a loss of 1.51 trillion dollars for the year (and more in subsequent years).

[33] Again, strictly speaking, the result follows while holding the saver's or investor's total lifetime tax burden constant to isolate the substitution effect.

[34] Schmidtz, *Elements of Justice*, 172.

[35] Eric Engin and Jonathan Skinner, "Taxation and Economic Growth, *National Tax Journal* 49, no. 4 (1996): 635–36.

Bentham, Mill, Marshall, and Pigou all understood the production-discouragement effects. And accordingly they anticipated the point that Schmidtz makes against Thomas Nagel (1991), that even within the Benthamite framework, fully egalitarian redistribution does *not* follow from the goal of happiness maximization and the assumption of diminishing marginal happiness (DMH) from wealth once we consider a world where wealth must be produced (rather than received as manna from heaven), and where taxing the production of wealth reduces its volume.[36] To paraphrase Schmidtz (by speaking of "happiness" rather than "utility," and by strengthening the claim as warranted by economic reasoning about production), in a world where resources and effort have to be expended to produce happiness-yielding goods it is not generally the case that multi-period (sustainable or lifetime) happiness is maximized by transferring command over goods to those for whom the goods yield the most happiness in the current period. Reaching the highest sustainable path of happiness over time will instead require taking into account the cumulative benefits of leaving resources in the hands of those who use them most productively.

Note that talking about happiness as a function of wealth or income seems less appropriate, in a world of saving and production, than talking about happiness as a function of consumption. Not all wealth or income is consumed. If saved income does not yield happiness until the period when it is dis-saved and consumed, differences in consumption are a better proxy than differences in incomes for the degree of inequality in happiness. In practice, differences in consumption spending are considerably smaller than the differences in disposable income across income quintiles.[37] This should not be surprising, because it follows immediately from higher-income individuals saving considerably more. If we consider differences in what Adam Smith called the "necessaries of life," like nutritional intake, the differences are even smaller. Smith noted in *The Theory of Moral Sentiments*[38] that, when it comes to foodstuffs, the rich "consume little more than the poor," although "they select from the heap what is most precious and agreeable."

VII. The Public-Goods Argument for Wealth Redistribution

Formalized by Paul Samuelson,[39] the theory of public goods offers a preference-based or Pareto-efficiency case for collective action. A "public

[36] Schmidtz, *Elements of Justice*, 140–49; Nagel, *Equality and Partiality*. To avoid ambiguity, I speak of happiness and DMH where the literature often speaks of "diminishing marginal utility" or DMU, using "utility" in the Benthamite sense of happiness.

[37] W. Michael Cox and Richard Alm, "By Our Bootstraps: Economic Opportunity and the Dynamics of Income Distribution," Federal Reserve Bank of Dallas *Annual Report* (1995), 20.

[38] Adam Smith, *Theory of Moral Sentiments* (Indianapolis: Liberty Classics, [1759] 1976), 184–85.

[39] Paul A. Samuelson, "The Pure Theory of Public Expenditure," *Review of Economics and Statistics* 36, no. 4 (1954): 387–89.

good" is one whose potential users are in the aggregate willing to pay enough to cover its production costs, yet its production cannot be financed on the usual user-pays basis because (with current technology) non-payers cannot be excluded from enjoying it, and therefore *not* paying is a dominant strategy (the "free-rider problem" prevails). In such a case, so the argument goes, there are amounts *we would each contractually agree* to pay, rather than go without the good, such that the pooled payments would be great enough to cover production costs. No individual would pay more than he or she is willing to pay. The well-calibrated collection of funds to pay for a public good does not levy an involuntary tax on the payer, but merely enforces a (hypothetical) voluntary contract.[40] The provision of public goods in this way is therefore a Pareto improvement. The *failure* to provide genuine public goods is a failure to capture potential gains from trade.

The proposition that *egalitarian redistribution is a public good* uses public goods theory to make an efficiency case for egalitarian redistribution by the state.[41] Suppose that some individuals are willing to pay for a reduction in observed inequality, or alternatively a minimum living standard for the poor. They may value the transfer for its own sake, or for the sake of an expected consequence like social stability. Each such individual prefers contributing some amount to help fund a large collective transfer program, over buying other goods available at an equal price to him, *provided* that enough others also contribute to achieve the desired large impact. If we generally view public goods provision by the state as a collective means of satisfying individual preferences in cases where the free-rider problem blocks user-pays provision, and suppose that payments can be calibrated not to exceed anyone's willingness to pay, then we arrive at a preference-based Pareto-efficiency case for an egalitarian redistribution policy. Unlike the Benthamite case, it does not require interpersonal aggregation of happiness. The assumptions establish that there is some redistributive policy that can satisfy the unanimity test for a Pareto improvement. Harold M. Hochman and James D. Rodgers sketched the case as follows:

> [I]t is possible that some redistribution will make everyone better off. . . . If, for example, the utility of individuals with higher incomes depends upon and is positively related to the incomes of persons lower

[40] Because this is not a tax on earning income, progressive or otherwise, it does not have any disincentive effects on work. Note that payments would not be the same for any two individuals if the project organizer were to have willingness-to-pay information allowing individualized price discrimination.

[41] Harold M. Hochman and James D. Rodgers, "Pareto Optimal Redistribution," *American Economic Review* 59, no. 3 part 1 (1969): 542–57; Lester C. Thurow, "The Income Distribution as a Pure Public Good," *Quarterly Journal of Economics* 85, no. 2 (1971): 327–36. In parts of this section I draw on White, *Clash of Economic Ideas*, 353–55.

> in the distributive scale, tax-transfer schemes which raise the disposable incomes of those in the poorer group may improve everyone's utility level. Where this is true, as we shall assume, Pareto optimality . . . is not only consistent with but requires redistribution.[42]

Lester Thurow similarly argued:

> The distribution of income itself may be an argument in an individual's utility function. This may come about because there are externalities associated with the distribution of income. Preventing crime and creating social or political stability may depend on preserving a narrow distribution of income or a distribution of income that does not have a lower tail. Alternatively, individuals may simply want to live in societies with particular distributions of income and economic power.

Citing Samuelson's definition of a public good, Thurow argued that individuals cannot effect a desired change in the distribution of income noncollectively because the benefit of observing a more equal distribution is non-excludable, and so the free-rider problem prevails:

> In short, the income distribution meets all of the tests of a pure public good. Exclusion is impossible; consumption is non-rival; each individual must consume the same quantity. The same [free-rider] problems also occur. Each individual has a vested interest in disguising his preferences concerning his desired income distribution to avoid paying his optimal share of the necessary transfer payments.[43]

Here an individual's "optimal share" is the amount that captures all available net benefits from transfers subject to the constraint that he not pay more than he is willing.

The argument just sketched is purely an exercise in armchair speculation: *if* we imagine that assumptions h_1 through h_m hold, *then* it follows that everybody would agree to redistribution program Y. To insure that any real-world tax-financed redistribution program actually brings about a Pareto-improvement, policymakers would have to go beyond *supposing* that taxpayers are each willing to pay enough for a specified transfer program such that aggregate payments would cover the program's cost, to *establishing* that each taxpayer really does agree to pay his assigned share (conditional on the program failing to go forward without it). Establishing actual willingness to pay, Thurow acknowledged at the end of his article, is blocked by the free-rider or demand-revelation problem: "It is possible to imagine attempts to measure individual preferences concerning the

[42] Hochman and Rodgers, "Pareto Optimal Redistribution," 543.
[43] Thurow, "The Income Distribution as a Pure Public Good," 327–28.

distribution of income, but these would run into the familiar revealed preference problems common to all public goods."[44]

The Hochman-Rodgers and Thurow discussions of redistribution illustrate the indefinite extendibility of the public goods argument. It can be used to recommend any change from the laissez-faire outcome that an analyst *supposes* will provide benefits for which individuals are willing to pay but are currently blocked by the free-rider problem. The benefits need not be tangible. The individual's assumed benefit from a change in the income distribution comes just from *knowing* something, and need not be manifested in any cost-bearing behavior. The lack of any evidence that individuals actually are willing to pay for the change is attributed to the free-rider problem.

So how can we ever *know* that individuals actually are willing to pay enough to cover the cost of a proposed public good like income redistribution? In the nature of the case, we never can. As Samuelson immediately recognized, when the payment organizer asks how highly one values the good, "it is in the selfish interest of each person to give false signals, to pretend to have less interest in a given collective consumption activity than he really has."[45] When an individual claims low willingness to pay, however, he may well be telling the truth. Public-provision advocates may claim greater aggregate private willingness to pay than actually exists. When we see a good *not* being produced in the absence of collective action (and we always see *more* of a good not being produced), it needn't be that free-rider problems are blocking what all would agree is worth doing. It could be that the good in question isn't really worth producing in the eyes of all those who would bear the cost. We don't know actual magnitude of willingness to pay, and by the inbuilt logic of the assumed free-rider problem, exclusion of non-payers being infeasible, we have no way of finding out.

The claim that "redistribution of income is a public good" is thus nonfalsifiable. It cannot be tested without a demand revelation mechanism.[46] Without some method for testing suppositions about other people's willingness to pay for income redistribution, claims to the effect that "redistribution is an underprovided public good" are without any evidentiary foundation. Equally unfounded are claims that a transfer program achieves a Pareto improvement, because the Pareto criterion requires that the payments taken from any individual are no greater than he would have agreed to make.

[44] Thurow, "The Income Distribution as a Pure Public Good," 335.

[45] Samuelson, "The Pure Theory of Public Expenditure," 388–89.

[46] If we magically had a demand revelation mechanism, we might still need collectively arranged rather than ordinary user-pays provision because of a strategic problem: I won't pay my share unless I know that others will also pay theirs. But collective provision could proceed voluntarily, on the basis of *actual* consent, via a binding agreement to contribute that does not go into effect until all sign it (what David Schmidtz, *The Limits of Government* [Boulder, CO: Westview Press, 1991] calls an assurance contract). We would not be asked to regard mere suppositions about willingness to pay as a justification for what, in the absence of actual consent to pay, is coercive taxation.

VIII. Buchanan on Distributive Justice

James M. Buchanan has suggested that a representative person behind the veil of ignorance would rationally choose constitutional rules empowering government to provide certain redistributive measures, namely inheritance taxation and public funding of basic education. These measures do not aim to reduce inequality in the wealth or income that members of a market society *end up* with at retirement, but rather to reduce inequality in the wealth and human capital with which (through no merit or fault of their own) they *enter* the market society at school-leaving age. Great inequality in starting points, he proposes, violates "our ordinary sense of 'fairness'." Here Buchanan clearly argues as a contractarian political theorist, not as a neoclassical economist. He bases the constitutional deliberator's supposed preference on supposedly shared moral intuitions about fairness, rather than on benefits associated with capturing available gains from trade. The economic analysis of gains from trade takes an initial (pre-trade) assignment of property holdings as given. Buchanan is proposing to reallocate holdings prior to an individual's starting to trade, which can only be for reasons other than capturing available gains from trade under the given assignment.[47]

There are other possible ways to motivate Buchanan's constitutional deliberator. One is an appeal to strong risk aversion. Buchanan's redistribution policies can then be viewed as insurance against an unfavorable draw in the starting-point lottery, the cost of which (lower mean wealth due to administrative costs and output-discouraging effects of redistribution) the deliberator would agree to bear *ex ante* for the sake of avoiding the risk of starting far below the mean.[48]

In either framing, Buchanan's justification for redistribution has one feature in common with a public goods argument. Claims about what "we" would agree to in a hypothetical constitutional deliberation behind the veil, like claims about individuals' willingness to pay, for which there is no demand-revelation mechanism, are unfalsifiable. I can introspect about my own actual preferences, but I cannot establish introspectively that my preferences are those of a representative individual behind the veil.

Other preferences that might with equal plausibility be attributed to the constitutional deliberator do not imply choice of inheritance taxes or public funding of basic education. For example, the representative deliberator might be concerned only with complete legal equality of opportunity and not with material starting points. She might regard even constitutionally

[47] James M. Buchanan, *Liberty, Market, and State: Political Economy in the 1980s* (New York: New York University Press, 1986), 130.

[48] David Gordon, "Justice and Redistributive Taxation: James Buchanan versus Ludwig von Mises," *Review of Austrian Economics* 8, no. 1 (1994): 117–31, notes that Buchanan's fairness argument does not rest on economic theory, and that his recommended redistributive policies can be framed as insurance.

authorized confiscation of inheritances above some size as a policy that violates the legal principle of nondiscrimination and gives government too much power.[49]

Or a reasonable deliberator might prefer government only to insure a minimum starting point to all citizens, and not to deny large inheritances to the offspring of the rich in pursuit of reduced inequality in starting points for its own sake. This is particularly likely if she recognizes that high rates of inheritance taxation capture little revenue to be redistributed to the disadvantaged, just like high rates of income taxation as discussed at the outset of this paper, but shrink the pie, because they divert potentially productive labor into the creation of legal vehicles for inheritance-tax avoidance. She might then regard the cost of pursuing equalization of starting points through inheritance taxes to exceed the benefit, and prefer to fund social insurance another way.

IX. Conclusion

To summarize: The economic way of thinking, contrary to what some economists have claimed or suggested, does not provide a compelling efficiency rationale for redistribution of income or wealth. The concept of diminishing marginal happiness from income or wealth, which underlies the utilitarian case for redistribution, plays no part in economic theory. The economic logic of choice rests instead on preferences, which are ex-ante and non-hedonic. The concept of a "social welfare function," still popular in optimal tax theory, is likewise extrinsic to the logic of choice by individual agents.

Economic logic *is* used by those who propose that redistribution is a "public good" in the sense of economic theory, but their proposition that consumers have sufficient (although unrevealed) willingness to pay cannot, in the nature of the supposed case, be falsified or supported with evidence. James Buchanan offered a related case for taxing inheritances based on suppositions about our common preferences that are equally unfalsifiable, and no more plausible than alternative suppositions about our preferences.

[49] Thus William Leggett, "True Functions of Government" [1834], in Leggett, *Democratick Editorials*, ed. Lawrence H. White (Indianapolis, IN: Liberty Press, 1984), 3–4, wrote, from such a contractarian perspective: "The fundamental principle of all governments is the protection of person and property from domestic and foreign enemies; in other words, to defend the weak against the strong. . . . The functions of Government, when confined to their proper sphere of action, are therefore restricted to the making of general laws, uniform and universal in their operation, for these purposes, and for no other. . . . . Whenever a Government assumes the power of discriminating between the different classes of the community, it becomes, in effect, the arbiter of their prosperity, and exercises a power not contemplated by any intelligent people in delegating their sovereignty to their rulers. . . . No nation, knowingly and voluntarily, with its eyes open, ever delegated to its Government this enormous power, which places at its disposal the property, the industry, and the fruits of the industry, of the whole people."

The economic way of thinking does speak clearly, however, about the negative consequences of egalitarian income taxes on the generation of income, and the negative consequences of wealth taxes on the production of wealth through effort and saving. The size of income and wealth losses is an empirical question. The empirical evidence suggests large losses for large redistributive programs. That a price in reduced overall prosperity must be paid for egalitarian policies is not a decisive objection for those who place high value on egalitarian efforts, of course. But the price must be understood in order for citizens or policymakers to make an informed decision.

Economics, George Mason University