JUSTIFICATIONS FOR REDISTRIBUTION: A CRITIQUE

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Abstract
It is striking that there are so many theoretical justifications of redistribution by government. Is it because each single justification is weak? I review and criticise the various arguments advanced in the literature. The main distinctions are between (a) Paretian justifications asserting that all, including the net payers, benefit from redistribution, (b) theories of justice and (c) utilitarianism. My conclusion is that redistribution ought to be based on Paretian arguments as far as possible and that helping the poor is more likely to maximise the happiness of all than is a general levelling of income differences.

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1. Introduction

Why is it that so many reasons have been given to justify redistribution of income and wealth? Why is there not one single generally accepted justification? Are there difficulties with each of these lines of argument? I shall try to show that this is indeed the case. I shall criticise the various justifications from economic and philosophical perspectives, examining their assumptions and questioning their conclusions.

The main distinction is between theories asserting that all people, including the net payers, benefit from redistribution (so-called Paretian redistribution) and those which do not make this claim.

How can the payers benefit from redistribution? They may be affected by the well-being and behaviour of the recipients, and redistribution may improve both. For example, transfers to the poor may relieve the recipients' feelings of pity and fear. In other words, they may reduce negative spillovers. Ideally, they may even generate a positive spillover: the joy of the altruist.

Envy is a negative spillover as well. Does it justify redistribution?

According to another Paretian justification, redistribution should be regarded as the result of an optimal income insurance contracted at birth against the vicissitudes of life. But this is not the case. If redistribution by government makes everybody better off, it may be agreed by all in a social contract. Redistribution requires coercive taxation but the government's use of force may be regarded as based on general consent 'at the constitutional level'. Indeed, the poor may not be prepared to sign the social contract unless it provides for transfers in their favour. Is redistribution the price of 'social peace'?

To turn to the non-Paretian justifications, there are, first of all, the arguments from justice. Once more, a confusing number of concepts and theories has been proposed. I shall deal with nine of these justifications. Is redistribution 'just' in the ordinary sense in which we use this term? Or are we really talking about solidarity?

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Another non-Paretian theory is utilitarianism. Does redistribution increase the recipients' utility more than it reduces the payers' utility? In other words, does it raise or lower collective utility, that is, the happiness of all? Can we know? How? What if we don't?

To reveal the fallacies of redistribution is not to prove that all redistribution is mistaken. But if the case for coercive redistribution rests on weak foundations, considerable caution is required. Some forms of redistribution are more dangerous than others. It is much easier to justify the fight against poverty than a general levelling of income differentials.

2. Redistribution as the price of social peace?

The first Paretian justification we should examine is that redistribution is a 'social mollifier': it is considered to be the price of social peace. The argument comes in three versions.

First, social peace is established at the level of the social contract or constitution. People agree on a set of rules and institutions to overcome anarchy. To attain unanimity side payments may be required. This possibility has been discussed by James Buchanan (1975, pp. 178 ff.).

Second, after the rules have been unanimously adopted they may be reneged on. Transfers may be required to prevent the poor from committing crimes and revolting against the established order. James Tobin (1977), for example, has made this point.

Third, redistribution alleviates envy.

2.1. Would a social contract provide for side payments to the poor?

Social contract theory is often misunderstood. It does not assume that existing states have been founded by unanimous agreement of their citizens. Historically, this has hardly ever been the case. The social contract is, and is meant to be, a theoretical device. Since the time of Thomas Hobbes (1651), it has been used as a criterion of political legitimacy: if the rules and institutions of a state could have been agreed in a social contract, they are considered to be legitimate. However, it has to be admitted that such hypothetical arguments are always speculative. Ideally, people ought to be asked whether they actually agree to the constitutional arrangement. The test of legitimacy is in the voting.

The starting point of social contract analysis is the prior or alternative state of anarchy. What sort of distribution prevails in anarchy? Or, in Buchanan's words, what is the 'anarchistic equilibrium'? In his two-person island model, there is war between Robinson and Friday. Robinson is stronger than Friday and therefore tends to win. Robinson may rob or blackmail Friday. Living on an isolated island, Friday cannot escape. Both Robinson and Friday are likely to waste resources by producing and carrying weapons. If they agree to renounce the use of force and respect each other's freedom, both may be be better off. Friday, who tends to be defeated in anarchy, gains more from peace and freedom than Robinson does. As a general rule, the weak benefit more from freedom than the strong. That is why, according to Friedrich von Hayek, the market economy is 'social' in itself – even in the absence of redistribution.

Would the social contract – in addition to establishing peace and freedom – provide for side payments from the rich to the poor? As Friday gains more from the contract than Robinson does, he may be willing to give a side payment to Robinson. For example, his payment may be such that they equally share the gain from the social contract – the so-called 'peace dividend'. David Gauthier (1987) has argued that, under certain conditions, it would be rational for self-interested individuals to agree on an equal sharing of the gain from cooperation. But this would imply redistribution from the weak and poor to the strong and rich. The model does not justify redistribution from the rich to the poor – quite the contrary.

If we leave the two-person model, we have to allow for the fact that, in the real world, there are more Fridays than Robinsons. This is the iron law of the Pareto distribution: in each society the distribution of market income and productivity is skewed. Robinsons are rare. There are more people below the average than above. How does this affect the direction of potential side payments?

First, the scarcity of Robinsons raises their price in the market economy. It augments the income differential between the Robinsons and the Fridays. But this is also likely in anarchy: if there are few Robinsons, each Robinson gets a larger share of the food accessible to the Robinsons.

Second, since there are more Fridays than Robinsons, the weak may unite and succeed in defeating the strong. In this case, two collective agreements would be concluded: first, a contract among the weak and, second, the social contract between the weak and the strong. The strong would gain more from the social contract than the weak do, and they might agree to pay transfers to the weak. But the story presupposes that in anarchy the weak prevail over the strong. John Stuart Mill (1861, p. 315), for one, rejected this view:

> The rich would be far better able to protect themselves, in the absence of law and government, than the poor, and indeed would probably be successful in converting the poor into their slaves.

To sum up, social contract theory does not seem to call for transfers from the rich to the poor.

2.2. *Redistribution to fight crime?*

Even though the social contract has been unanimously adopted, individual signatories may renege on their obligations. If legal enforcement of the contract is costly, transfers to the poor may be a better way to maintain order. This justification rests on three assumptions:

1. Poverty is a cause of crime.
2. Transfers to the poor reduce crime.
3. Redistribution to the poor is a more efficient way of fighting crime than legal enforcement.

Assumption 1 is eminently plausible – especially if the poor are close to starving. Several econometric studies have shown that the correlation between poverty and crime is positive (for an incomplete survey, see Kelly 2000). This finding is independent of the political persuasion of the authors. However, there is no positive correlation between poverty and terrorism (e.g. Krueger 2007).

Assumption 2 does not follow from assumption 1. Even though transfers to the poor reduce poverty and poverty causes crime, the transfers may fail to reduce crime if, in addition, they also have effects – for example, incentive effects – which increase crime. In other words, the effect of poverty on crime may depend on whether the income distribution is the result of transfers. This complication deserves to be analysed in some detail.

In economic terminology, crime is a 'negative externality' (or spillover). A affects B negatively without paying a price. Since A does not take into account the cost to B, he causes an inefficiency. The standard remedy against negative externalities is a tax equal to the damage. In environmental economics we call this the ‘polluter-pays principle’. But poor criminals cannot be taxed. On the contrary, the proposed remedy is to give them money for not committing crimes. The larger the expected damage from crime, the more money they get. Therefore, it pays criminals to threaten and commit more crimes in order to extort more transfers. This is the well-known appeasement problem. It means that redistribution may easily be counterproductive – especially if the criminals are organised. Moreover, as more transfers lead to more crime and more crime to more transfers, an explosive feedback process may develop. There may be no equilibrium. Furthermore, large-scale redistribution is likely to undermine tax morale. For these reasons transfers to the poor may not reduce but encourage crime.

Assumption 3 depends on the cost of legal enforcement and the degree of poverty. If the poor live at the subsistence level, their lives cannot be made much worse by penalties. Thus, legal enforcement is less likely to impress and deter them. Moreover, they are less likely to reduce their work effort in response to transfers. The poorer the poor, the smaller the benefit from legal enforcement and the damage from redistribution. But the reduced effectiveness of legal enforcement in the case of the poor is insufficient to justify transfers to the poor if assumption 2 does not hold, that is, if such transfers fail to reduce crime.

Thus, it is quite doubtful that the aim of reducing crime warrants redistribution.

2.3. Envy

The negative external effects run not only from the poor to the better-off but also in the opposite direction: the poor suffer from envy. Any narrowing of income differentials would reduce envy. Does envy justify the levelling of incomes by governments?

If envy is rewarded it pays the poor to show more envy. Their envious rhetoric may help them to get more money. This is the appeasement problem in another guise.

Moreover, just as there is envy among the poor there is pride among the better-off. The better-off are proud of earning more income and owning more wealth than the poor. If government redistributes from the better-off to the poor, it reduces the pride of the better-off. We do not know whether the gain from relieving envy is larger or smaller than the loss from destroying pride. Thus, envy is a weak basis for demanding redistribution.

So much for social peace.

3. Other negative spillovers: begging, disease, drug addiction and the homeless

Similar considerations apply to another negative externality of poverty: begging. If beggars are a nuisance, the better-off may be willing to pay for public transfers to potential beggars. But again this creates an incentive to increase the nuisance. The incentive problem may explain why, historically, poor laws have typically granted the dole and prohibited begging at the same time. The transfers were not considered sufficient to stop begging.

Finally, since the poor are more likely to be sick, contagion is a negative externality of poverty. In this case, there is no incentive problem: transfers will not induce the the poor to catch more contagious diseases. On the contrary, better nutrition improves their health. But transfers of money are not the most efficient instrument to prevent the poor from catching contagious diseases. The most efficient solution is vaccination wherever possible. It should be subsidised and might even be made compulsory just as the punishment of crime is compulsory.

The poor are more likely to be homeless and addicted to drugs. Drug addiction is not contagious but like begging and homelessness it can become a nuisance. Transfers would reduce this nuisance. They can be in kind and limited to these groups. The provision of housing for the homeless and treatment for addicts are not likely to cause major incentive problems. However, these negative spillovers do not justify general cash transfers to the poor.

4. Positive spillovers among donors

The poor may obtain transfers from the government but also from private donors. As John Stuart Mill (1848, V. xi. 13) has pointed out, private transfers are often superior to public transfers:

> Private charity can give more to the deserving. The state must act by general rules. It cannot undertake to discriminate between the deserving and the undeserving indigent. It owes no more than subsistence to the first, and can give no less to the last.

Thus, private charity reduces the incentive problem. If the donor is led by compassion, she takes the recipient's joy into account. To this extent, as economists would say, the externality is 'internalised'. But does she also allow for the fact that other altruists will rejoice as well when a poor person receives aid? If not, does the government have to step in and complement or replace private charity?

This potential justification of government redistribution has been analysed by Hochman and Rogers (1969) in a well-known article. However, there are several difficulties with this argument. To simplify let us assume that there are three people: an altruistic donor (A), a poor beggar (B) and a co-altruist (C).

First, even though A's gift to B pleases C as well, increasing the gift may not. This is because the positive external effect on C may be 'intramarginal'. For example, C may believe that additional transfers to B would seriously weaken B's work effort. In this case, A's gift is optimal.

Second, if A is a true or 'universal' altruist, she will take C's pleasure into account. Hochman and Rogers assume a partial or 'myopic' altruist. If A is altruistic towards everybody, including C, she will give the optimal amount.

Even if these two objections do not apply, a third one has to be considered. If C feels that A is giving too little to B, why does he not top up her gift? If the top-up equals C's (marginal) benefit from giving to B, private charity would work optimally, and there would be no need for redistribution by government. The argument is well taken but it may not hold if there are many co-altruists, because the transaction cost of arranging the top-ups can be prohibitive. In the large-group case, it may be the task of government to lower the transaction cost. People may agree on a social contract empowering the government to subsidise private charity from tax revenue. Or, as is the case, the subsidies take the form of tax rebates for donors. Thus, positive spillovers among altruists do not justify government transfers to the poor.

Of course, private charity is not always altruistic. If people give with the sole purpose of enhancing their prestige or obtaining some service in return, they are not altruistic. If there is no altruist, there is no spillover among potential donors and consequently no need for top-ups or government subsidies.

5. Redistribution as income insurance?

Several authors have suggested that, in a social contract, individuals may agree on public insurance against the vicissitudes of life – notably negative shocks to their income. For example, they may wish to insure for a guaranteed minimum income to be financed from some tax. *Ex post* – that is, after the shock has occurred – the insurance redistributes income from the lucky to the unlucky but *ex ante* – that is, before the shock – it may appear to be fair and attractive to all. Buchanan and Tullock have presented this Paretian justification of redistribution in their classic study *The Calculus of Consent* (1962, ch. 13). Subsequently, it has eagerly been taken up by many well-known advocates of the welfare state (e.g. Arrow 1963; Rawls 1971; Mirrlees 1974; Diamond et al. 1980; Varian 1980; Sinn 1995; Lindbeck 2006; Blundell et al. 2008). Does it justify present-day redistribution?

Social contract theory assumes people who are capable of signing a contract, that is, adults. It cannot refer to human beings who have just been born. Adults are aware of their endowments, and they have expectations. They know that they are and will be unequal. If government offered to guarantee a minimum income, they would know that their probabilities of falling short of this minimum would differ. Other things equal, those expecting high incomes would pay lower contributions than those expecting low incomes. Thus, the tax financing the minimum income would have to be regressive. But that is not what we observe in the real world.

This is not to deny that adults face income risk. But does it justify the provision of income insurance by government? Two additional conditions have to be met. First, the benefit from income insurance must be larger than its cost. Insurance is a costly institution. People's (marginal) willingness to pay must exceed its (marginal) cost. Efficiency does not require, and, indeed, is unlikely to be compatible with, insurance against all risks. Second, government must be a more efficient provider of income insurance than the market is.

Several arguments have been presented why this may be so. To start with, insurances benefit from the law of large numbers. The larger the number of customers, the lower tends to be the insurer's overall risk. If marginal cost keeps falling, competition destroys itself, and one private supplier – the most efficient one – prevails as a 'natural monopolist'. To the extent to which potential competitors face costs of entering the market, the monopolist may abuse his market power, that is, charge too high a price and produce too little output. In these circumstances, a public insurance may be more efficient (even though it would suffer from bureaucratic waste). In the real world, however, we hardly ever observe monopolies in the insurance business. Insurance companies tend to be large but they compete. Thus, the first argument in favour of government insurance is not convincing.

Another argument relies on the fact that the government has a competitive advantage in measuring the income of the insured. A provider of income insurance must be able to measure income more or less accurately. The tax authorities have to ascertain taxpayers' income anyhow. They could use this information as an income insurer without additional cost. But the information available to the tax authorities could also be passed on to a person's private insurance at his request. Insurance and measurement are separate activities. They can be undertaken by different producers according to their comparative advantages.

Finally, competing private insurers may suffer from adverse selection due to another information problem. To be efficient, providers of income insurance must not only be able to measure income *ex post*. They must also, so the argument runs, be in a position to assess individual income risk *ex ante*. If they cannot distinguish between high- and low-risk customers and if, consequently, they charge the same premium to both, the low-risk individuals demand too little insurance, possibly none at all. In one-period models, this may appear to be a serious problem. In repeated games, the insurers do observe the risk performance of the insured over time. Thus, they gradually reduce the premia of their lower-risk customers and raise the premia of their higher-risk customers accordingly. But even if, in the short run, there is adverse selection, insurance does not have to be provided by government. It is sufficient to make private insurance mandatory for some time, obliging all citizens to buy some minimum amount of insurance from the insurer of their choice. As this arrangement would be efficient, it should meet with unanimous approval in a social contract. Why don't we observe it?

To sum up, real-world redistribution is very different from the *ex post* redistribution implied by an optimal income insurance. There may be many good reasons for government guaranteeing a minimum income but the case for insurance is not among them. As insurance, the governmental system of redistribution is neither fair nor efficient.

This ends our discussion of Paretian redistribution.

6. Contractual justice

Many people believe that it is possible to define a just distribution of income or wealth, that it differs from the existing distribution and that it is possible and desirable to move from the existing to, or towards, the just distribution via government transfers and taxation. This raises the question of what we mean by justice. One of the first philosophers to address this question was Aristotle. In his *Nicomachean Ethics* (Book V) he distinguished between three concepts of justice which in scholastic teaching became known as 'iustitia commutativa', 'iustitia retributiva' (or 'correctiva' or 'regulativa'), and 'iustitia distributiva'.

'Iustitia commutativa' is the justice of contracts or civil law. 'Iustitia retributiva' refers to the justice of punishment and penal law. And 'iustitia distributiva' is the justice of giving in a group – for example, by public authorities or the head of a family. It plays a role in public law and the law of inheritance. We start by exploring the implications which these three concepts of justice have for redistribution in a society.

'Iustitia commutativa' requires that the distribution of income and wealth is entirely due to private contracts or other voluntary actions. Anarchy has been overcome. Individuals have property rights which are protected by the government and can be traded. Contracts are enforced by the law courts or by private arbitration panels. The distribution resulting from contracts is considered just because it is not based on theft, fraud or force as it could be in anarchy.

Under contractual justice, redistribution by government is limited to two tasks. First, if property has been stolen or robbed, the government is supposed to give it back to its rightful owner. Second, if the partner to a contract does not meet her obligations, the civil law courts award damages to the claimant.

Contractual justice corresponds to the classical concept of freedom: the role of government is confined to protecting citizens against each other. In economic terminology, this is equivalent to saying that the sole purpose of government is to prevent negative externalities.

Robert Nozick (1974), a Harvard philosopher, introduced the distinction between justice as a process and justice as a pattern. If justice is meant to refer to a process, we cannot tell whether a given distribution of income is just unless we know how it has come about. By contrast, if justice is meant to refer to a pattern, we merely have to measure the inequality of the income distribution – it does not matter for justice how the income differences have arisen. Contractual justice is obviously a process concept of justice: the distribution is just if all transfers of income and wealth have been voluntary.

7. Retributive justice

'Iustitia retributiva' is the principle that everybody ought to be punished according to his deeds. Criminal law, just like civil law, focuses on the damage that has been done. (But it also takes intentions into account.) Applied to the distribution of income, retribution implies that everybody ought to be rewarded according to his performance. In the language of the economist and more precisely, a person's income ought to equal the market value of his output. Thus, remuneration according to output and punishment according to damage are two sides of the same coin – retributive justice. Remuneration is the positive side while punishment is the negative side.

Retributive justice, like contractual justice, is a process concept of justice: whether an income distribution is to be called just or unjust depends entirely on people's actions in the past – on their productivity.

Why does the principle of retributive justice exist? David Hume (1751) suggested that 'the rules of equity … owe their origin and existence to that utility which results to the public from their strict and regular observance' (p. 188); 'The necessity of justice to the support of society is the sole foundation of that virtue' (p. 203). A somewhat qualified version of this view recurs in the work of Friedrich Hayek (1976, p. 98): 'We can't have any morals we like or dream of. Morals, to be viable, must satisfy certain requirements. … What is required is not merely consistency. A system of morals must produce a functioning order, capable of maintaining the apparatus of civilization which it presupposes.'

The main purpose of punishment is deterrence. The purpose of remuneration according to output is encouragement. Thus, the rationale of retributive justice is setting the right incentives. Retributive justice aims at the common good as defined either by a social contract or by a utilitarian calculus.

7.1. The problem of inheritance

Retributive justice and contractual justice have different implications for the just income distribution. Contractual justice requires that all transfers are voluntary. This is not enough for retributive justice: the voluntary transfers must be payments for services rendered and priced at their market value. This means that donations and bequests are considered unjust even though they are agreed between donor and recipient in explicit or implicit contracts. The adherents of retributive justice disapprove of donations and bequests because they believe that these transfers do not serve to provide appropriate incentives and may even weaken the recipients' incentive to work and save.

Those who prefer contractual justice to retributive justice oppose the prohibition and taxation of donations and bequests. They present three major objections. First, it is very difficult to prevent people from making and receiving donations, and even bequests cannot be stopped completely. The government can easily control transfers of land but, if land cannot be passed on, many owners will sell it and donate money. If there is an inheritance tax or death duty, it is easily evaded by donating money before death. In short, retributive justice cannot be attained, and the cost of pursuing it is larger than the gain to society.

Second, to the extent that people can be prevented from donating and bequeathing their property they save less and work less. The incentive effect on potential donors is negative.

Third, if A wants to give and B wants to take, both are made better off and nobody is made worse off. Thus, overall utility in society rises. Why should such transactions be prohibited or discouraged? This is the general case for freedom of contract (provided that the contract does not hurt others). It holds regardless of whether the common good is defined by an unrestricted utilitarian calculus or by a social contract. If government intervention has to be justified by a real or hypothetical social contract, there is the additional problem that the prohibition or taxation of donations and bequests is not likely to be accepted by all.

Before turning to distributive justice I shall discuss some further concepts of justice which are retributive.

7.2. Equal opportunity

Equal opportunity takes the retributive argument a step further. It does not only exclude donations and bequests but any differences in starting conditions. Those who are born with poor health, little talent or no parental wealth do not deserve their disadvantage. Just as there is no point in punishing (rather than detaining) a mentally ill person in criminal law, there is no good reason why the untalented ought to be poor. They cannot help it. Thus, equal opportunity requires that the disadvantaged are compensated by public transfers. In particular, there must be equal access to education. Only if a pupil has failed to make use of his talent, for example being lazy at school, may he be denied access to higher education. Public transfers to the disadvantaged would be financed by a tax on the windfall endowments of the lucky.

Like the case against inheritance, the precept of equal opportunity rests on the retributive argument that differences in income and wealth which are not justified by differences in performance are not required to set the right incentives. Equal opportunity extends this argument from donations and bequests to the arbitrariness of nature. Compensation for the whims of nature will not have undesirable incentive effects because nature does not respond to incentives.

The precept of equal opportunity seems to imply that nature or its creator is unjust. Hayek (1976, pp. 32 f., 68, 78) has raised the question whether nature – say, a stone – may be said to be unjust. In ordinary language, 'just' and 'unjust' refer to human behaviour or rules adopted by humans. A possible answer to Hayek's question is that nature is neither just nor unjust but morally blind. But that is not how the creator is usually seen. Why would a benevolent creator bring about or tolerate large differences in initial endowments including poverty, poor health and misery? This is the problem of theodicy. I shall not try to solve it.

The justice of equal opportunity is not easily attained. There is an information problem and, following from it, an incentive problem. At birth very few of the differences in endowment are observable. Even if the child suffers from some obvious physical defect, the required compensation is difficult to calculate. The same is true for the differences in talent and beauty which become visible at a later age.

If the government tries to measure and tax talent and beauty and compensate for the lack of them, people will adjust their behaviour. They will hide their talent and beauty – at least some part. Thus, the problem of measurement becomes a problem of incentives. Some talent is wasted, and there is a lack of beauty – with negative external effects.

As it is difficult to measure the value of human capital (in its widest sense), one may try to infer it from the income stream which it generates. But the utility derived from beauty, for example, is not only a matter of income, and income is not only a function of talent – it also depends on effort and the willingness to take entrepreneurial risk. If, in the name of equal opportunity, government taxes flows of income rather than stocks of human capital, it reduces effort and risk-taking (see especially Johnson 1975). It weakens the individual's willingness to make use of his resources. It replaces the disincentive to showing talent and beauty with the disincentive to working and daring. Which is worse? Probably the latter.

Nothing might be lost, and much gained, if nature started with an equal distribution of endowments. But much is lost in terms of incentives, output and income if government tries to bring it about. Since the (marginal) cost of measuring and reducing the differences in endowments is very substantial, completely equal opportunity is probably not optimal. Some measures, such as equal access to education and compensation for physical handicaps, are not marred by serious measurement and incentive problems. But many others are. Some inequality of opportunity can be justified on these grounds.

Hayek (1960) has dared to suggest that equality of initial endowments would not be ideal even if nature provided it. His reason is that risk-taking and the innovation that follows it require large sums of capital. Society benefits if there are some born capitalists. Sooner or later the benefits of innovation accrue to all members of society. Therefore, all members of society might be willing to agree to such inequality of opportunity. The empirical weight of this consideration depends on whether and how far a potential innovator can convince or persuade others to invest in his project. If he can, he does not need to own much capital himself.

7.3. To everyone according to his effort

If starting conditions were totally equalised, income would depend on effort and the vagaries of life. Retributive justice requires that income should not be affected by luck – neither at birth nor during life. Does it follow that government ought to redistribute income so as to reward effort or compensate for bad and good luck? Once more, there is an information problem and an incentive problem.

As measuring effort is difficult, if not impossible, governments confine themselves to taxing some types of windfall gains and providing free treatment of some diseases. For example, in some countries windfall gains due to building permits are siphoned off. Windfall losses due to diseases can be compensated by health insurance. Such insurance is available in the market. Each individual is free to decide whether to buy this type of justice. There is no need for government to intervene.

If the government could measure and reward effort directly, it would not improve but distort incentives. As income would be paid for effort rather than output, there would be no incentive to direct one's effort to the most productive uses. What is worse, there would be a perverse incentive. The strongest effort has to be made by the least talented. Thus, everybody is led to choose the occupation for which he is least talented. The remuneration of effort rather than output is a recipe for the most far-reaching misallocation of labour.

7.4. To everyone according to his good will

Perverse reactions can be avoided if only well-intentioned effort is rewarded. Some philosophers, notably Immanuel Kant (1785), have suggested that the essence of morality is good will. More precisely, the morally good person is defined by his good will. This contrasts with the consequentialist interpretation of ethics: not the intention of the actor but the effect of his actions is the defining characteristic of morally good behaviour. The most famous economist proposing such a consequentialist conception of ethics has been Adam Smith. He started his academic career as a moral philosopher. The best quotation is from *The Wealth of Nations*: in the market the individual is 'led by an invisible hand to promote an end which was no part of his intention. … By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it' (1776, IV. ii. 9). The reason is that producers who cut their marginal cost do not only raise their profits but also consumer surplus.

Not only do good consequences follow from self-interested behaviour in the market. It also happens that bad consequences follow from good intentions due to lack of knowledge. There may even be a negative correlation between piety and the worldly knowledge of how human action – say, government policy – affects society. Is the commandment 'to love your neighbour as yourself' about intentions or consequences?

7.5. To everyone according to what he does for others

To turn to consequences, retributive justice may refer to the contribution which a person actually makes to society – his 'social worth'. This is also often described somewhat vaguely as public reward according to 'virtue' or 'desert' or 'merit'. A well-known proponent of this view is John Stuart Mill (1861, p. 318):

> … society should treat all equally well who have deserved equally well of it, that is, who have deserved equally well absolutely. This is the abstract standard of social and distributive justice, towards which all institutions, and the efforts of all virtuous citizens, should be made in the utmost possible degree to converge.

The idea goes back to Aristotle (*Nicomachean Ethics*, Book V). Like Mill, Aristotle calls it distributive justice but its guiding principle is retribution.

From an economic point of view, there are three types of contribution which a person can make to society: consumer surplus, producer surplus and positive external effects. Consumer surplus and producer surplus are part of the market process while positive external effects are a form of non-market interdependence.

Consumer surplus is unintentionally provided by producers selling at a uniform price (i.e. in the absence of price discrimination). Usually, some buyers are willing to pay more than the market price but if the good is tradable the producer cannot discriminate against them. His price equals the willingness to pay of the last (i.e. marginal) buyer. The other buyers pay less than they are willing to. They earn a surplus.

For the same reason consumers enable producers to earn a producer surplus. If the cost of producing an additional unit rises as output increases and if market price equals the cost of the last unit (i.e. marginal cost), the producer receives more than he needs to cover the cost of his intra-marginal units. Thus, producers, too, earn a surplus: profits.

Consumer surplus and producer surplus together are called economic rents. The concept of economic rent was unknown at the time of Adam Smith but it is at the bottom of his famous insight that 'by pursuing his own interest' every consumer and every producer 'promotes that of society'.

Positive external effects, by contrast, are not part of the market process. The extreme case is private charity motivated by pure altruism. More often the externality is a beneficial side effect of some action guided by self-interest. Technical innovation, building of a lighthouse or erecting a beautiful monument are classic examples. As we have seen, the beneficiaries may be willing to pay if the group is small but in the large-group case government subsidies may be justified. This is not true for economic rents because rents are automatically generated by the market process. If government pays for positive external effects it has to levy taxes from which to finance the subsidies. Since taxes distort incentives, complete justice according to social worth is not likely to be optimal. It is better to stop short of full justice.

So far we have assumed that social worth can be measured and that the cost of measurement is negligible. There is no information problem in the case of rents. Rents are created by voluntary contracts. They reflect the producer's cost and the consumer's willingness to pay. Each contracting partner knows the value of the surplus he is gaining. The same is true if beneficiaries voluntarily pay for positive external effects. But if governments try to reward positive externalities with the help of subsidies, they face a severe information problem because the benefits cannot be measured by external observers.

In the context of ethics, this point was made by David Hume (1751). Since, in his opinion, morals 'owe their origin … to that utility which results to the public' or 'to the support of society' (as mentioned above), he wondered whether they also call for justice according to social worth:

> [The] most obvious thought would be, to assign the largest possessions to the most extensive virtue. … But were mankind to execute such a law, so great is the uncertainty of merit, both from its natural obscurity and from the self-conceit of each individual, that no determinate rule of conduct would ever follow from it, and the total dissolution of society must be the immediate consequence. (p. 193)

This may be an exaggeration but what is the alternative? Social worth would have to be attributed by appointed or elected judges of virtue. There would be tribunals of inquisition. Ultimately, such a system of rigorous retributive justice would require a totalitarian state quelling all opposition. The trade-off between freedom and justice presents itself in a new guise.

Ironically, as Michael Young (in *The Rise of Meritocracy*, 1956) pointed out, the weak and less productive members of society would probably not be happier but less happy. Producing less, they provide a smaller consumer surplus to others. Unable to give much, they do not create large positive external effects. Having been attested as of little social worth, they could not even excuse their unfavourable position.

8. Maximising the smallest income (Rawls)

Before turning to the pattern concepts of distributive justice, we should consider a very influential modern concept of justice which, according to its author John Rawls (1971), is another process concept.

In Rawls's opinion, justice requires that government augments the (percentage) *share* of the smallest individual income in society up to the point where the bureaucratic and disincentive costs of further redistribution would so much reduce the aggregate income of society that the *amount* of the smallest individual income would actually fall (even though its *share* would rise). To put it briefly, Rawls wanted to maximise the smallest income ('maximin'). He added another condition for justice to which he gives priority: each person is to have an equal right to the most extensive freedom compatible with the freedom of others where freedom includes property rights, political participation and freedom of speech and assembly. The equality before the law which he demands in these respects is an aspect of equal opportunity. One might think that the right of property is incompatible with the large-scale redistribution of income and wealth which the maximin principle is likely to imply. However, Rawls limited the right of property to protection against 'arbitrary seizure'. Expropriation for the benefit of the poorest does not count as arbitrary.

Rawls's definition of justice is probably not what people mean by justice but it has received too much attention to be ignored. It combines elements of classical freedom, political rights, equal opportunity and just income redistribution. Is the justice of maximin a process concept or a pattern concept of justice?

It is not possible to tell, just by looking at the pattern of the income distribution, whether it maximises the smallest income. Maximin justice is about what would happen to the poorest if his income share were increased. It is a forward-looking concept. It does not refer to some process in the past. It is neither pattern- nor process-oriented. It is future-oriented.

However, this is not how Rawls himself saw it. Rawls argued that maximin justice would be agreed in anarchy if people did not know their personal endowments. Behind this 'veil of ignorance' the individual cannot but take the point of view of society including the poorest member of society. Indeed, Rawls claims that everybody would take the perspective of the poorest because the probability of being the poorest is unknown. Everybody would agree to a social contract that aims at maximising the smallest income. Therefore, Rawls concluded, maximin justice is a process concept of justice.

At first glance, Rawls's construction seems to have some appeal – even to classical liberals: (*a*) it mentions property rights, (*b*) it allows for the bureaucratic and disincentive costs of redistribution, and (*c*) it is based on a social contract. But the policy conclusion – 'maximise the smallest income' – is as socialist as it could be. What went wrong?

First, as John Harsanyi (1977) was probably the first to point out, people behind Rawls's veil of ignorance would not simply choose the perspective of the poorest. As they are considering a social contract with other individuals they necessarily know that the probability of not being the poorest is positive. If the frequency distribution of endowments – but not their owners – were known, people would act as if they possessed the average endowment. Should people be assumed to be ignorant of the frequency distribution? No, because such a restriction on information is not needed to induce people to take the viewpoint of society, nor would it enable Rawls to deny that the probability of not being the poorest is necessarily positive.

Thus, the maximin concept of justice does not follow from Rawls's hypothetical social contract. It is not a process concept of justice.

Second, Rawls's social contract cannot ever have been concluded. All constitutional agreements, it is true, are reached in conditions of uncertainty. But people know who they are and what they have. Rawls's veil of ignorance is so thick that it cannot have existed. Can the assumption of a social contract that cannot be, and cannot have been, concluded in the real world justify anything – let alone a far-reaching programme of redistribution? What are the arguments?

The social contract approach is the classical liberal alternative to unrestricted utilitarianism. The main problem of unrestricted utilitarianism is that reliable interpersonal comparisons of utility are impossible. Social contracts, by contrast, do not require interpersonal comparisons of utility. They generate ('Pareto-')improvements for society as a whole because all individuals gain and nobody loses. Social contracts maximise the happiness of all under the restriction that the utilities of different individuals cannot be compared. Thus, the crucial advantage of contracts over unrestricted utilitarianism is that contracts are observable while the utilities of other people are not. Contract theory provides an operational criterion of social improvement while unrestricted utilitarianism does not. But a Rawlsian social contract which cannot possibly have been concluded is by definition non-operational. It misses the point of the contractarian approach.

It is interesting to compare John Rawls with Karl Marx. Both were guided by the interest of the least advantaged rather than the general interest of society at large. Marx in *Das Kapital* (1894, p. 828) redefined freedom to mean absence of poverty and of exploitation. Rawls redefined justice to mean maximisation of the smallest income (subject to restrictions). Both invented 'persuasive definitions' to impress and mislead their audiences.

Rawls's maximin principle is not about retributive justice or contractual justice. It is a peculiar concept of distributive justice focusing on one person in society – the poorest. This is not how distributive justice is usually understood.

We turn to traditional notions of distributive justice.

9. Distributive justice

For Adam Smith distributive justice was about private giving:

> ... distributive justice … consists in proper beneficence, in the becoming use of what is our own, and in applying it to those purposes either of charity or generosity to which it is most suitable. (1759, VI. ii. 1)

By contrast, Aristotle and his followers, as we have seen, applied the term distributive justice primarily to public expenditure – focusing on social worth.

9.1. Equal sharing

The simplest pattern concept of justice is equal sharing. If justice means equal sharing, the income distribution can be declared just or unjust simply by looking at the degree of inequality – say, the Gini coefficient.

In its application to public policy, equal sharing is related to equality before law. Equality before the law means equal access to, and treatment in, the courts. It is a concept of justice originating from the administration of civil and criminal justice. But equality before the law could also mean that laws have to be general and that all citizens enjoy the same political rights.

Arthur Okun (1977, p. 16) argued that the case for equal sharing of income follows from the equal sharing of voting power in a democracy:

> If … a preference for equality operates in the social and political realm, it must apply to the economic realm as well. … Egalitarian preferences do not – and logically cannot – stop abruptly at the boundary line between economic and non-economic institutions. The case for economic egalitarianism can be inferred from the equality of sociopolitical rights.

This is an argument from analogy. But analogies have to be justified. Are they relevant? Why should a rule that is generally accepted in one field, politics, be transferred to another field, economics?

While it is just to treat equal cases equally it is unjust to treat unequal cases equally. Justice requires that unequal cases are treated differently. This may explain why the principle of equal sharing does not have a wide field of application. Each case is different in some respects, and there is little agreement about which of these respects are relevant and which are not.

9.2. To everyone according to his needs

The obvious alternative concept of distributive justice is (re-)distribution according to need. In particular, there are said to be 'basic needs' which have to be satisfied – if necessary by income redistribution. The legislator, but also a father, should give to those who most need it. The criterion of need plays an important role in social policy and development aid. It is used to justify Christian mercy and socialist solidarity.

'To everyone according to his needs' is the principle of justice which Karl Marx (1875) recommended in his critique of social democracy. However, real-world communists found it impractical. The constitution of the Soviet Union (1936, art. 12), for example, declared: 'In the U.S.S.R. work is a duty and a matter of honour for every able-bodied citizen, in accordance with the principle: "He who does not work, neither shall he eat."'

The USSR followed the socialist principle 'From everyone according to his ability, to everyone according to his performance'. As we noted above, this is not a concept of distributive but retributive justice.

The needs principle is a pattern concept of justice. The observer compares the existing income distribution with the apparent pattern of needs. It is irrelevant whether the poor person has caused his poverty himself by negligence or even intention. It does not matter whether his calamity is undeserved or self-inflicted. As the process by which the need has arisen is ignored, the needs concept of justice weakens the incentive to think, work and save.

Is the needs principle implied by unrestricted utilitarianism? Is utilitarian redistribution, therefore, just – as John Stuart Mill (1861, ch. 5) claimed? No. Utilitarian ethics claims that income ought to be redistributed in favour of those who derive the largest utility from additional income. But these may be high-income earners – so-called 'utility monsters'. The logic of unrestricted utilitarianism does not exclude reverse redistribution from the poor to the rich. But the needs concept of justice is meant to justify transfers from the affluent to the needy. It can be incompatible with utilitarian redistribution.

'Utility monsters' are discussed in more detail in the section on utilitarianism, to which I now turn.

10. Utilitarian redistribution

Utilitarianism can serve different purposes. It can be a normative theory justifying value judgements (as in Bentham and Mill). But it does not have to be normative. It may alternatively be a positive theory interpreting or explaining the value judgements of people in a society. For example, a philosopher may claim that people, when passing moral judgements, use the happiness of all as their ultimate criterion. Utilitarianism in this case is about the meaning of moral statements (logical utilitarianism). As an explanation, on the other hand, utilitarianism is empirical. For example, we may say with David Hume (1751) that moral argument, to be effective in a society, must be about 'the utility to the public' or that, for a society to survive in the struggle for existence, 'the utility to the public' must be its guiding principle. In the following we are exclusively concerned with unrestricted normative utilitarianism, and my critique of utilitarian redistribution is not meant to question positive utlitarianism.

In its simplest form the utilitarian justification of redistribution rests on the following four assumptions:

1. The utility of additional wealth (i.e. marginal utility) diminishes as the individual's wealth increases.
2. The marginal utilities of different individuals can somehow be measured and compared.
3. People of the same wealth have the same marginal utility of wealth.
4. Total wealth in a society is independent of redistribution by government.

If all four assumptions hold, the maximisation of the utility of all requires that everybody has the same wealth. For if everybody has the same wealth and thus by assumption 3 the same marginal utility, redistribution cannot raise total utility.

The most heroic assumption is, of course, assumption 4. Redistribution is not costless. It weakens the incentive to work and save and requires a costly bureaucracy. If the cost of redistribution is large, it may outweigh the assumed utility gain from redistribution.

Assumption 3 is heroic as well. While some people are easily satisfied others – the 'utility monsters' – do not arrive at a low marginal utility of wealth unless they are very rich. They accumulate more wealth because they want to consume more in the future or because they have more special and expensive tastes or because they derive more utility from showing their riches or because they are more afraid of the future.

If person A derives more utility from additional wealth than person B does, even though both own the same wealth, then A may also have a higher marginal utility than B does when A is wealthier than B. But if this is the case, the combined utility of A and B is maximised by redistributing wealth from poor B to rich A. This is why, as we have noted, utilitarianism is logically compatible with reverse redistribution if assumption 3 does not hold, and empirically this is perfectly possible.

Of course, it is also possible that with equal wealth B would have a higher marginal utility than A. That would strengthen the case for redistribution from the rich to the poor. Thus, we should not only ask what is possible but which of the two possibilities is more probable.

Abba Lerner, in chapter 3 of his book *The Economics of Control* (1944), suggested that, in the absence of further information, both possibilities are equally probable. This would mean that, at any given identical level of wealth, A and B are expected to experience the same marginal utility so that assumption 3 would hold on average. From this Lerner drew the following conclusion: 'If it is desired to maximise the total satisfaction in a society, the rational procedure is to divide income on an equalitarian basis' (1944, p. 32). But is his equiprobability assumption 'rational'? Ian Little, a welfare economist, joked in 1950 (p. 59): '. . .from complete ignorance nothing but complete ignorance can follow.'

Yet we know more: equiprobability is improbable. There is a strong reason to expect that, if they had the same wealth, those who are in fact rich would experience a higher marginal utility than those who are in fact poor. The reason is that individuals who value wealth more highly tend to work and save more and consequently possess more wealth. They are more wealthy because, at any given level of wealth, their marginal utility of wealth is higher. For a rich person wealth is likely to be more important than for a poor person. Therefore, it is not rational to divide wealth or income on an equalitarian basis. If wealth is distributed very unevenly, some redistribution from the rich to the poor may be justified in spite of these differences in marginal utilities but the optimum would clearly fall short of equality.

We now turn to assumption 2: is it possible to measure and compare the marginal utilities of different individuals? Three types of evidence are available: introspection, non-verbal behaviour and what people say. There is no direct way of observing other people's happiness. Maybe, one day, neurologists will invent a 'utilometer'. For the time being we have to do without it.

By introspection, each individual can rank the utilities which he derives from successive additions to his wealth. If pressed hard, he might try to quantify them. Introspective evidence should not be dismissed out of hand. But it cannot be shared. It cannot be checked by external observers. It is not scientific. Its scientific role is limited to inspiring testable hypotheses about outward behaviour.

Non-verbal behaviour may seem to justify some ordinal interpersonal comparisons of marginal utility but it does not permit interpersonal comparisons of cardinal utility.

We are left with what people say – for example, in opinion polls. There is a burgeoning literature of quantitative happiness research. But it is not helpful for the problem at hand. Some of the difficulties are recognised by the authors. For example, terms like 'happiness' or 'satisfaction' may not mean the same thing to different people – notably if translated into other languages. (Does this explain why people in Costa Rica are notoriously found to be among the happiest in the world?) Or people may differ in their willingness to admit that they are not happy. (Does this explain why econometricians find men to be significantly less happy than women?) But the crucial problem concerning redistribution is this: if redistribution is made to depend on what people say about their happiness, they have an irresistable incentive to misrepresent their feelings. It would pay to overstate one's marginal utility of income and wealth. Since marginal utility is private information, strategic behaviour is rational.

For these reasons, the 'new welfare economics' renounced interpersonal cardinal utility comparisons and social welfare functions as non-operational and unscientific (Robbins 1938). The focus shifted to Paretian – that is, consensual – redistribution. Redistribution ought to be based on Paretian arguments as far as possible.

Politicians are neither scientists nor scholars. They rely on what they consider common sense and on opinion polls. But even as a practical matter, the lack of reliable evidence should caution against drastic action. If the risk of committing a mistake is high, it is optimal to use the policy instrument sparingly (Brainard 1967).

Risk aversion differs among people. Therefore, opinions about the preferred scope of redistribution are necessarily subjective, and redistributive policies are divisive. They undermine the willingness to cooperate. The probabilty of making a mistake depends on the extent to which market incomes differ. Redistribution from the very rich to the really poor is less risky than a general levelling of incomes. This is why classical – in particular Christian – social policy has traditionally focused on the fight against poverty and why only the very rich had to pay for it.

11. Conclusion

In the twentieth century, social policy has undergone two fundamental changes. First, its thrust has shifted from fighting poverty to a general levelling of income differences based on Gini coefficients. Second, social policy has moved towards favouring the median voter or, what comes close to it, the median income earner. George Stigler (1970) called this 'Aaron Director's Law'. Oliver Pamp (2011) found that the middle-income group has been gaining from income redistribution in 15 out of 16 OECD countries. The only exception is Switzerland. The middle-income group benefits most in France, the US, the UK and Germany (in this order). The results of Jens Alber (1989) supported these findings for Germany. Using a more limited data set, Branko Milanovic (2000), an author from the World Bank, did not confirm Director's Law, however.

Politicians redistribute in favour of the middle-income group by giving in-kind transfers or transfers for specific purposes to those below a certain income limit. For example, housing assistance is offered to low- and middle-income earners, and the income ceiling is set somewhat above the median income. Since the middle-income group spends more on housing than the low-income earners do, the middle class is the main beneficiary. The same is true for subsidies to saving. The middle class has more income to save than the poor do. A third example is the subsidisation of higher education subject to an income limit. The children of middle class parents, for various reasons, are more likely to enter higher education than the children of the poor.

The middle-income earners also gain because there are more people who earn less than average income than people who earn more than average income. There are more Fridays than Robinsons. Given this skewed distribution of market incomes, the combination of a lump-sum transfer and a proportional income tax is sufficient to generate a net transfer to the middle class (Meltzer and Richard 1983). An example of such equal transfers is state-provided primary education that is freely available to all – even the children of high- and middle-income earners.

In a democracy there is a strong temptation for both right-wing and left-wing parties and party coalitions to redistribute in favour of the median voter. The middle class has a vested interest in propagating redistribution by government, and so do the poor. It is all the more important that such propaganda is criticised by independent scholars.

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