THE FREEMAN
IDEAS ON LIBERTY

Government Redistribution Impoverishes the Poor

by Dwight R. Lee

Only the most ideologically blinded continue to argue that socialism can outperform capitalism in the production of wealth. Yet the assertion that government programs are required to reduce the income inequality generated by capitalism is widely accepted as revealed truth. Market competition motivates productive activity by threatening with poverty those who use resources unwisely, and carrying out this threat without mercy. So, it is argued, in the absence of compassionate government transfer programs, a large percentage of the population would be left behind, impoverished, without hope, and made all the more miserable by the audacious wealth of their more successful neighbors.

The Benefits of Failure

There is just enough truth in this view to obscure the fact that it grossly distorts reality. Market competition can be harsh. But the particular failures dispensed by market competition provide the information and motivation that are indispensable to the general economic success of any economy. When failures in the marketplace are viewed in isolation from the success they make possible, they are commonly depicted as unfair. In fact, in the marketplace failure and fairness go hand in hand. When people suffer failure in the marketplace they are making a necessary contribution to the general productivity of the economy—a contribution that enhances the opportunities of all to produce wealth, in an economic system that distributes that wealth far more widely and equally than most people realize. Each person would, of course, prefer to be protected against failure while continuing to benefit from the contribution that the failures of others make to economic progress. The fundamental fairness of the market lies in the fact that it gives no one a free ride on the contribution of others. In the unfettered marketplace everyone has to contribute to the general prosperity by accepting the failures as well as the successes that come his way.

Yet, because the failures that result from market competition are commonly seen as unfair, arguments calling for government to help the poor find sympathetic ears. Government action to help the poor is seen as the only way to overcome the perceived unfairness of the marketplace. Invariably what people have in mind when considering government help for the poor are government

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programs that supposedly transfer income from the rich to the poor. Seldom do those who favor such transfer programs question whether they actually reduce income inequality.

While most people recognize realistically that income is distributed in the marketplace in response to competition between people interested primarily in private advantage, they somehow believe that income is distributed in the political process in response to broad social goals such as reducing income inequality. The unstated assumption is that when people shift from market activity to political activity they experience a moral metamorphosis, overcoming considerations of private interest in order to advance the public interest. Yet, there is no convincing evidence that people in their roles as politicians, bureaucrats, members of special interests, and voters are any less driven by self-interest than they are as investors, workers, and consumers in the private sector.

A Major Unsupported Assumption

Once the importance of political competition is recognized, an important, but seldom considered, question presents itself: Why should we expect the income distribution resulting from political competition to be any more equal than the income distribution resulting from market competition? Unless one is prepared to argue that (1) the skills necessary for successful political competition are different from those necessary for successful market competition and (2) the poor possess relatively more of the politically relevant skills than the nonpoor, then there is no reason to believe that government transfer programs will help the poor.

The evidence fails to support the hope that the poor can compete successfully against the nonpoor for political largess. Little of the income distributed by government is from the rich to the poor. Studies of the distribution of after-tax/after-transfer income over the last several decades find little, if any, change in the equality of that distribution. Based on these studies, economist Robert Haveman of the Institute for Research on Poverty of the University of Wisconsin has concluded, "In spite of massive increases in federal government taxes and spending, we were about as unequal in 1988 as we were in 1950."

There are government programs, of course, that transfer income to the poor. But programs that transfer income to the poor receive political support through a process of legislative logrolling that disproportionately favors programs that transfer income to the nonpoor. The poor end up receiving no greater share of existing wealth transferred by political competition than they do of new wealth created by market competition.

There is no debate over the fact that transfer programs reduce economic growth by discouraging productivity and encouraging dependency. By reducing the overall size of the pie without increasing the share of that pie going to the poor, government transfer programs have reduced the absolute income of the poor. The inescapable conclusion is that government transfer programs have made the poor worse off.

Free market capitalism excels at producing wealth and at distributing it widely. Even those left behind by market competition benefit from the productivity of the marketplace. It is far better to be poor in California than in Calcutta. There are those, however, who disparage the market economy on the grounds that market competition unfairly distributes income. This view has been used effectively to justify transferring more of the nation's income through governmental programs. The result has been unfortunate for the poor. Substituting negative-sum political competition for positive-sum market competition reduces the size of the economic pie without increasing the share of that pie going to the poor. □

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How Much Money?

by Bettina Bien Greaves

Do we need more money as the population increases? Do we need more money as production expands? That would seem logical. But is it?

What individuals *really* want is not more money, but more purchasing power. Money itself isn't wealth. Look at Germany in 1923. The Germans had plenty of paper money then—billions and billions of Marks. But with all that money, they had little or no purchasing power. A housewife considered herself lucky if she could find a baker willing to take a wheelbarrow full of paper money for one loaf of bread. It is the purchasing power of money, not the money itself, that counts.

Money Has Two Basic Functions

(1) as purchasing power. A money whose purchasing power can be relied on is the most efficient means for individuals to obtain the many varied goods and services they want. Each of us always wants to hold a certain amount of money for future purchases.

(2) as a means for comparing the market values of various goods and services. Because billions of German Marks were being printed in 1923, the purchasing power of a single Mark dropped practically to zero. Germans no longer wanted to hold Marks. Rather, they used every ruse they could devise to exchange their useless Marks promptly for something tangible. Also, as the Mark declined in value, comparisons with various goods and services became increasingly unreliable. By the end of 1923, German Marks were completely useless for either of money's two basic functions.

Money is the medium of exchange people offer in the expectation of obtaining various goods, services, and leisure time. All very well and good. But when there are more people and when more goods and services are being produced, won't more dollars be needed if the extra people are to buy the additional goods and services? Won't more dollars have to be created to cover all this additional spending and keep people producing and prosperous?

No! The answer, as the German case shows, isn't more dollars. The answer is more purchasing power. And here the market provides the answer.

Suppose the population has increased but the quantity of money or credit has not been artificially expanded. Then more would-be buyers will be competing to buy the goods and services available. The same amount of money will have to stretch farther. Would-be producer/sellers will have to sell at what would-be buyers can afford to pay—or else forgo sales. If would-be producer/sellers do not anticipate artificially induced increases in the quantity of money, they will not keep asking higher and higher prices, as sellers often do nowadays; they will be willing to drop their asking prices, especially if they feel confident that the cost

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