DS124.DO

ON THE DRY SIDE HOW MUCH FOR THE POOR John Hyde

Published
5-4-85

How much assistance should be given to those with low incomes? Everyone knows the question but few venture an answer. The 'more' and the 'less' schools do not become 'so much' schools expressing their preferences in absolute or in relative terms. This question without an answer is the subject of a short paper written by the economist, Mancur Olson. Although he too is far from answering it, I think his argument, which I sumarise, is not only useful but a thing of beauty.

Much of the poverty debate is conducted in the terms of rights, usually called human rights; so before asking how much wealth our society should guarantee, we should ask if the recipients have a natural right to receive and society a natural obligation to give. Is any measure of wealth a human right? Should poverty be made 'illegal' in the same way that barriers to free speech, arbitrary arrest and arbitrary seizure of one's property are, or should be, illegal? Is the language of human rights a useful approach to this problem? Olson, who favours wealth transfers to alleviate poverty, argues that the problem of poverty raises questions which are of a different order from those raised by classic human rights debate.

The natural rights can be, and in free countries are, guaranteed by laws and traditions which curb those with power to deny freedom to others - in particular they are guaranteed by a tight rein on the government itself. Freedom from poverty (a right to wealth) cannot be guaranteed by a simple prohibition placed in the way of people bossing other people. A right to wealth, if such a right exists, is different from the human rights. First, unlike oppression, of which governments have a near monopoly, governments are not the direct sources of poverty or wealth. No matter what a law may say, the courts cannot guarantee that wealth will be produced. Second, a right to protection against poverty is a claim on what others produce, prejudicing established rights of ownership. Third, while there is little cost in protecting the natural rights, guaranteeing wealth is costly. The wealth must be found and wealth transfers discourage production. There comes a point at which the cost of the transfers cannot be borne and compromise is inevitable. The absolute entitlements that are human rights are not relevant to this debate, and that approach does not help us to decide whether to compulsorily transfer wealth from one citizen to another and it certainly doesn't tell us how much to transfer.

A better case for subsidising the poor than one relying on the 'right' of the poor to receive, rests simply on utility. We are instinctively aware of the law of diminishing returns. We know that when we are thirsty a glass of water is extremely valuable but that most of a bucket of water is not. Similarly a dollar is worth more to someone who has few dollars than to someone who has many. The person with few dollars gets more 'utils' of benefit from an additional dollar. It is this knowledge which encourages us to insure. We know that insurance companies pay out less in claims than they take in premiums, but we also know that after,say, a fire, dollars will be more use then than when the premiums are paid. In order to have dollars when they are needed most we accept the high probability of loss.

If poor people do get more bang for the buck than rich people, given a constant stock of wealth and a uniform demand for wealth, the community's aggregate utility is maximised by a completely egalitarian distribution. The philosopher John Rawls argued that if each of us were to face the future from behind a veil of ignorance about our own circumstances we would argue for a free society, because a free society would give us the greatest chance to attain our preferred life style. Rawls also applied the veil of ignorance to the question of how much should be given to the poor. His answer is disputed, but unlike almost everybody else, he has an answer. It is that no inequality should be allowed in a society except when the inequality makes the worst off person better off. Leaving the incentive issue to one side, other things being equal, then a given national (or for that matter world or shire) income yields most utility when it is evenly distributed. However all other things are not equal and Rawls did not suggest that they were. Insurance again reveals insights. When we buy fire insurance we cannot get 100% insurance lest we become careless with matches. As the insured value rises so does the likelihood of fire. Insurers call their problem 'moral hazard'.

If a private insurer were to offer unemployment insurance he would be unlikely to insure the worker for the full wage he might lose, lest people became unduly careless about hard work or skill maintenance. Further the insurer would know that the people most likely to become unemployed would be those most likely to insure. This latter problem is known as 'adverse risk selection' and since there is no way the insurer can know as much about the individual's risk as the individual himself knows, adverse risk selection makes some private insurances impossible. The problem is overcome only by government social insurance which makes insurance universal and compulsory.

Egalitarian income distributions, other things being equal, do generate more utility. And there is a way, albeit a way that sacrifices liberty, around the problem of adverse risk selection, but there is no known way round the problem of moral hazard. Laws, even with draconian punishments cannot prevent what cannot be distinguished and lack of will cannot be distinguished from lack of capacity.

The common sense conclusion is that there is much to be said for a more equal distribution of the fruits of the nation's orchard, but that the amount produced by the orchard will depend on the amount of work done in it, which will in turn affect the distribution. Hardly a novel conclusion, but the recognition that it is an insurance problem lets us draw on the theory and experience of the insurance industry in discovering how far we can safely go when redistributing those fruits.