“Social Utility” and Government Transfers of Wealth: An Austrian Perspective

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The Nature of the Free Market

One of the tenets of the Austrian position is that the free market invariably increases “social utility.” If government interferes with the market process, Ludwig von Mises wrote, “it can only impair satisfaction; it can never improve it” (p. 744). The reasoning is as follows. Since any voluntary exchange will take place only when each participant expects to benefit, “the very fact that an exchange takes place,” says Murray Rothbard, “demonstrates that both parties benefit (or more strictly *expect* to benefit) from the exchange.” Thus, since the free market is nothing more than “the array of all voluntary exchange that takes place in the world,” and since “every exchange demonstrates a unanimity of benefit for both parties concerned, we must conclude” that, provided all major externalities have been internalized, as they would be in a world of universal private property, “*the free market benefits all its participants*. . . . We are led inexorably, then,” says Rothbard, “to the conclusion that the processes of the free market always lead to a gain in social utility. And we can say this with absolute validity as economists, without engaging in ethical judgments.” (1956, p. 250).

This statement demands careful consideration in order to understand precisely what is and is not being claimed. In the real world, peoples’ expectations about the future are often mistaken and, hence, businesses suffer losses or go bankrupt and anticipated profits from investments often do not materialize. Further, individuals are often disappointed because their *proferred exchanges* are rejected. Are not both of these cases examples of where the market renders at least one individual worse off and thus refutes the Austrian position that the market *always* increases social utility?

Future Expectations

It is certainly true that businesses sometimes go bankrupt and the expected profits from investments do not materialize. But the Austrian claim is that individuals maximize their utility *ex ante*. This is certainly consistent with bankruptcy, unprofitable investments, the purchase of (losing) lottery tickets, etc. This can be easily demonstrated. Assume for simplicity that one has a .5 chance of having an investment yield a profit and a .5 chance of suffering a loss. If the individual believed that a profit would increase *future* utility more than a loss would reduce it, the discounted *present* value of that investment would be positive. This means that, *regardless of the actual outcome,* the decision to invest would increase one's present utility, while the decision not to would reduce it. Thus, the decision to invest would increase one's utility *ex ante,* even if it proved to be a mistaken choice and thus reduced utility *ex post.*

The significant point is that it is not the market, itself, that was responsible for reducing one's utility, but the uncertainty of the future. And this uncertainty, it must be emphasized, is an ineradicable element of nature and is therefore *independent* of any particular economic system.

In fact, since there are gains from trade to be made on the market by enabling others to reduce the risks they face, the market actually works to minimize uncertainty by enabling individuals to purchase insurance against practically any risk imaginable (Rothbard, 1970a, pp. 498–501; Rothbard, 1970b, p. 161).

In short, reduced utility resulting from mistaken expectations about the future is not inconsistent with the Austrian position regarding decisions *ex ante.* Further, such mistakes are due to the uncertainty of the future. This uncertainty is not the result of the market but is inherent in nature (Mises, pp. 105–6; Rothbard, 1970a, p. 5). Finally, it is actually the market process that operates to minimize this uncertainty.

Rejected Offers

But what of the second category of action? Would it not be correct to say that one who had an offer of an exchange rejected had utility reduced?

Assume for the sake of simplicity that two job applicants, Abbott and Costello, have equal ability. If Abbott offers to work for, say, \$5.00 per hour while Costello makes an offer of \$4.75 per hour, the employer will hire Costello. But if Abbott makes a counter offer of \$4.50 per hour, the employer would then hire Abbott. Costello must now decide whether he will offer less than \$4.50 per hour. Suppose he decides against this. Abbott would then be hired at \$4.50. Clearly, both participants, the employer and Abbott, gain. But what of Costello? Did he not lose? Was not his utility reduced? The answer is no. First, Costello had the option of underbidding Abbott. The fact that he did not do so indicates that for him no job was a better option than a job at less than \$4.50 per hour. Thus, Costello chose the better of the two options that actually faced him. That option was to make no exchange. That is, if

Costello were coerced, either by a gun-wielding employer or the government, into working for less than $4.50 per hour, his utility would be *lower* than it would be in the absence of coercion. Thus, Costello made the choice which maximized his utility given the options facing him at the time of that choice.

But Costello desired a job at $4.75 per hour. His hopes were dashed when Abbott offered to work at $4.50 per hour. Was not his utility reduced by having his hopes for the job at $4.75 dashed? Costello's failure to get the job does not mean that he is any worse off than he was *before* he made his offer. He did not have the job before he made the offer; he does not have the job after his offer was rejected. Thus, his *realized* or *real-world* utility plane is unchanged. What has happened is that his hoped-for increase in utility did not materialize; that is, his *realized utility plane* is lower than his hoped-for or *fancied utility plane*, i.e., the utility resulting from an alternative that either could not occur or could occur only through the use of violence. Of course, there must always be a discrepancy between one's actual and desired abilities, between one's realized and fancied utility planes. If this were not the case, if everyone's desires were fully satisfied, all action would cease, for any action would, by definition, entail a reduction in utility (Mises, pp. 13–14).

Put differently, the free market operates to increase every individual's *realized* utility plane. To complain of a discrepancy between realized and fancied utility planes is simply to complain that one's desires have not been fully satisfied. But this complaint reduces itself to the mundane observation that more is better than less, that abundance is better than scarcity. But scarcity, like uncertainty, is an ineradicable element of nature that is independent of any particular economic system. In fact, while scarcity cannot be eliminated, one can point out that the market is the most efficient institution for production yet discovered and is therefore a powerful engine for reducing scarcities. This can be briefly demonstrated.

Since consumers only buy what they intend to use, one can make a profit only by producing what consumers desire. This, of course, means that it is the consumers who ultimately direct production by their buying and abstention from buying. To produce their goods, the entrepreneurs must bid for the needed resources. They therefore stand in the same relation to the sellers of factors of production as the consumers do to the sellers of final goods. Thus, the price for the factors of production tend to reflect the demand for them by the entrepreneurs. Since what the entrepreneur can bid is limited by expected yield from the final sale of a product, factors are channeled into production of those goods most intensely demanded by consumers. If returns are not high enough to cover the cost of a particular operation, there is, in the eyes of the consumers, a more important use for the factors of production elsewhere. The market, therefore, allocates resources to their most productive point relative to the priority system that the consumers have established.

This can be demonstrated by the following. Assume that the market is in equilibrium. Also assume that a new technological breakthrough has enabled the production of a new commodity that is highly valued by consumers. The production of the commodity, however, requires the use of factor *A*. Those entrepreneurs who perceive this new profit opportunity will begin to bid for the factor. This increased competition for the available supply of *A* will cause its price to rise, forcing some of the users to *A* to curtail their purchases. But who will be the ones forced to curtail their purchases? Clearly, it will be those utilizers of *A* who are receiving the least remuneration for their product from the consumers, i.e., those who are employing *A* in its least productive point. In this way, the supply of *A* is channeled from uses that the consumers value less highly into uses they value more highly. But further, the rise in the price of *A* will encourage other entrepreneurs, also anxious to make profits, to expand the production of *A*. In this way, the free market works to employ "every possible factor of production for the best possible satisfaction of the most urgent needs of the consumer" (Mises, p. 744).

The important point is that if market prices are interfered with, they become distorted and no longer reflect the demands of society. Resources are misallocated and production impeded. Since these inefficiencies reduce the size of the economic product relative to what it would have been on the unhampered market, intervention can only serve to increase the discrepancy between realized and fancied utility.

The Nature of Government

Government is the agency that exercises a monopoly on the legal use of coercion in society. Government is not a productive institution. It has no resources that it has not first taken from others. This means that in order for it to *defend* individuals from aggression by others, it must *first* exercise *prior* aggression, *viz.*, taxation, in order to obtain operating revenues. Thus, violence is inherent in every act of government.

In order to understand what may be called the logic of the Austrian analysis of government, it is necessary to distinguish between the actual or *real-world situation* (the existing state of affairs) and what may be termed the *counterfactual situation* (the state of affairs that *would have occurred* had its emergence not been coercively prevented). Since on the free market, all individuals must either remain on the same utility plane or move to a higher one, the market (provided major externalities have been internalized) increases "social utility." And because coercion, either present or prior, is inherent in government, *any* government intervention into the market *must* reduce at least one individual's actual or realized utility relative to that person's counterfactual utility, that is, to what it would have been on the unhampered market. The conclusion of the Austrian approach is, as Rothbard points out (1956, pp. 252–53), that "no act of government . . . can increase social utility." Hence, he continues, "a free and voluntary market 'maximizes' social utility," provided, he quickly adds, terms such as *maximize* and *increase* are interpreted in an ordinal rather than a cardinal sense.

Currently, in excess of 50 percent of the budgets of practically all governments in the world are devoted to transfer payments. This makes wealth transfers, at least quantitatively, the most important function of government. The official justification for these activities is that they increase "social utility." Since transferring wealth from some individuals to others reduces choice sets of the former while expanding them for the latter, this means that some are forced to choose between options that provide them with less utility than those they would have chosen on the market, while others are able to choose from options that would not be open to them on the market. Since the utility of some is reduced while that of others is increased, any claim that social utility has been increased implies the ability to compare, if not measure, the utilities of different individuals. Thus, the *justification* for wealth transfers clearly implies the use of utility in its cardinal sense (Simon), defined here as the ability to measure and/or compare the utilities of different individuals. Those who maintain that wealth transfers can and do increase social utility should be able to support this claim with adequate evidence. The claim will be examined using two different standards: (a) what may be termed absolute *or apodictic certainty* and (b) the more relaxed standard of *reasonable certainty.*

What can be said with *absolute certainty* about the effect of government wealth transfers on utility in a cardinal sense? Since, despite numerous creative attempts, no one has been able to show that direct interpersonal comparisons of utility are possible, *nothing* can be said with absolute certainty about social utility when there are both gainers and losers. It is possible that the beneficiaries benefit more than the losers are harmed, thereby increasing social utility. The reverse is also possible. This means that it is impossible to ascertain whether a given government action increased or decreased net social utility or left it unchanged. As Rothbard has put it (1956, p. 252), "As economists we can say nothing about social utility in this case since some individuals have demonstratably gained, and some have demonstratably lost in utility, from the government action." But there is *one* possibility from which it is possible to draw conclusions that are *absolutely certain* even when coercion is present. If a coercive act (a) makes no one better off, but (b) leaves at least one person worse off, it follows that social utility is reduced.

The results of the foregoing are interesting. One may say with certainty that the market *always* increases social utility. On the other hand, one can *never* state with certainty that any act of government ever increases social utility, and the only conclusion one could ever make with absolute certainty is that a given act of government *reduced* "social utility." And this, as we shall see, is not as unlikely as might be thought.

This is as far as one can go while remaining in the realm of *absolute* certainty. However, by relaxing the standards from absolute to *reasonable* certainty, one cay say much more.[1] There are two ways to examine this issue: (1) indirect, interpersonal utility comparisons within a given time-slice and (2) intrapersonal utility comparisons over time. The question is, even using the relaxed standard of reasonable certainty, do these approaches provide any convincing evidence that coercive wealth transfers may increase social utility?

Indirect, Interpersonal Utility Comparisons

In ordinary speech we make interpersonal comparisons of mental states. We often hear or make statements to the effect that *A* is happier, sadder, more in love, or in greater pain than *B*. Granted that such loose talk can hardly qualify as scientific assessments, nevertheless, it would be rash to dismiss it as meaningless.

There is, it is obvious, wide variation in *what* makes different individuals happy or sad plus some variation in *how* individuals express these mental states. But that there is a great deal of sameness or commonality, especially in the outward expressions of our mental states, cannot be denied. For example, laughter denotes happiness; a grimace, pain. One can state with conviction, even of strangers, that they had happy expressions, showed friendly faces, were pictures of health, did not look well, or were in pain.

In a similar vein, people's tastes are in large part a product of their past personal histories, the quality and quantity of their education, and their culture. It is therefore reasonable to suppose that there is a great deal of variety, especially cross-culturally, in what affects our utilities. Observation appears to confirm this. But, again, this should not be interpreted as meaning that there are not equally significant similarities. Observation bears this out as well. Whenever and wherever people in socialist countries have been permitted to express their preferences (as in post-Mao China and, to a lesser extent, in the countries of Eastern Europe and the Soviet Union during the past two decades or so), they have opted for higher standards of living. A major reason socialist politicians have been so successful in the third world is that they have been able to convince large numbers of people that "redistribution" from the rich to the poor will bring them abundance. It seems clear that such politicians would receive very little support if they promised oppression and poverty. Indeed, the uniformity of the desire for material wealth, even cross-culturally, is remarkable, with Japan being only the most striking example. It is not too much to say that the life-style of the "materialistic West" is the envy of the world. Indeed, the lure of the "American Way of Life" sparked the largest migration in the history of the world (Sowell, 1981, p. 3).

This is not to say that all individual preferences are identical—which is obviously not the case. It is only to say that there is probably enough similarity to enable us to make rough comparisons with reasonable certainty.

This conclusion is strengthened by the "law of marginal utility" which informs us that *all* individuals *always* act to satisfy their most urgent (satisfiable) desire first, their second most urgent desire second, their third most urgent third, etc. This, of course, deals solely with intrapersonal rankings of preferences and therefore does not, in itself, permit interpersonal comparisons, much less measurement, of utility. But while this law says nothing about either the content or degree of particular individuals' utilities, it does show that all individuals act according to the same *process* or *principle, viz.*, the maximization of their utility, broadly conceived.

Put differently, the fact that all of us are members of the same species, homo sapiens, means not only that we must, by definition, possess certain essential traits in common, it also means that *introspection* is an available tool in understanding the members or units of that class. "Whenever we discuss intelligible behavior," Hayek has observed:

> We discuss actions which we can interpret in terms of our own mind. . . . If we can understand only what is similar to our own mind, it necessarily follows that we must be able to find all that we can understand in our own mind. . . .
>
> If what we do when we speak about understanding a person's action is to fit what we actually observe into patterns we find ready in our own mind, it follows, of course, that we can understand less and less as we turn to beings more and more different from ourselves. But it also follows that it is not only impossible to recognize, but meaningless to speak of, a mind different from our own. What we mean when we speak of another mind is that we can connect what we observe because the things we observe fit into the way of our thinking. (pp. 66–68)[2]

If Hayek is correct, then such universal principles of human action as the law of marginal utility combined with the observed similarities in such things as individual preferences and the outward manifestation of mental states permit us, after making due allowance for the observed variation in individual preferences, not to measure utilities but, rather, to make reasonably certain rough comparisons of utility.

If one insists on conceiving of utility in cardinal rather than ordinal terms, it follows that one must view it, just like any other phenomenon amenable to measurement, in terms of a continuum rather than a dichotomy. But since one cannot make *exact* measurements but, at best, only rough comparisons, the result would resemble a black/white color spectrum. One can distinguish black from white, but as one moves down the spectrum, one cannot tell where black ends and white begins. There is a massive "gray area" in between which is neither black nor white. Similarly, one can distinguish a child from an adult. One can even chart the evolution of the child into an adult, marking not just the years, but the months, days, hours, and even seconds. Yet, despite the precision of the measuring instrument, one is still unable to point to an exact time that the child becomes an adult. The same is true of the "utility continuum." Given (a) the differences in individual preferences and (b) the indeterminacy of interpersonal utility comparisons, assessments of differences in interpersonal utility planes are possible with even reasonable certainty *only at polar extremes*. To expect any more than this would be like trying to thread a needle with a jackhammer.

What, then, can be said with reasonable certainty of interpersonal utility comparisons? Compare, for example, the position of multimillionaire Robert Baron, III, with that of an indigent, Herb, living at or near starvation. An extra dollar would enable Robert to satisfy a preference that is ranked, say, one millionth on his utility scale while that same dollar would enable Herb to satisfy a preference that is ranked fifth on his. It is reasonable to suppose that the satisfaction of Robert's one millionth preference would not provide as much utility to Robert as the satisfaction of Herb's fifth preference would provide to him. It is, of course, conceivable that the reverse is the case. But for a dollar to provide Robert with more satisfaction than the indigent would so deviate from what observation, experience, and introspection tell us is typical for human beings as to be characterized as abnormal. And, since an abnormality is, by definition, a departure from the norm, the burden of proof is on those who assert an abnormality to demonstrate its existence rather than on others to disprove the assertion. In the absence of some fairly convincing demonstration of why and how either Robert's or Herb's sensibilities differ so markedly from those of ordinary human beings, the claim can be treated with a large degree of skepticism, if not contempt.

Does this lead to the conclusion that a massive redistribution of wealth would increase social welfare? I think not.

Wealth transfers can be divided into three types: (1) upward wealth transfers, where wealth is transferred from poorer to wealthier individuals or groups, (2) intragroup wealth transfers, where wealth is transferred from one poor individual or group to another poor individual or group, or from one middle-class individual or group to another, etc., and (3) downward wealth transfers, where wealth is transferred from wealthier individuals or groups to poorer ones.

Upward transfers of wealth would reduce the choice set among those whose choice set is already relatively small and expand the choice set among those whose choice set is already relatively large. The result is clear. It would reduce preference satisfaction among those who were already in the position of satisfying the fewest of their preferences. And it would increase satisfaction among those already in the position of satisfying the largest number of their preferences. Since such transfers move us in the position of polar extremes, one can be reasonably certain that upward transfers of wealth reduce social utility and, therefore, could not be justified on the basis of welfare criteria.

Since polar extremes are not present in intragroup transfers, it is reasonable to suppose that the benefits of the recipients are roughly offset by the costs to the payers. It is not possible, therefore, with any degree of certainty to show that transfers either did or did not increase social utility. Given this uncertainty, such transfers in and of themselves could not be justified on the basis of welfare considerations.

Downward transfers present the most interesting case. We have already seen that it is reasonable to assume that an additional dollar for Herb would increase Herb's utility more than the loss of a dollar by Robert would reduce his utility. Hence, downward transfers would appear to increase social utility. But appearances can be deceiving. For transfers, especially if they are either downward or intragroup, initiate a process whose outcome makes even the initial beneficiaries of the transfers worse off than they would have been even without the transfer. In order to understand this process, we need to turn to the second approach, the intrapersonal comparison of utility over time.

Intrapersonal Utility Comparisons over Time

The second approach differs from the first in that it does not attempt to compare the utilities of different individuals, but to compare the utilities of the same individual at different times.

Wealth can be obtained through two fundamentally different means: (1) voluntarily (i.e., through production, by exchange, or as a gift) or (2) coercively (i.e., by taking it from others).

Assume that Robert's wealth was obtained coercively. The transfer of all or a large part of Robert's wealth would reduce his utility. But there are additional results. Since he could no longer benefit from his coercive activities, the transfer would act as a deterrent or disincentive to coercion. And if Robert were permitted to retain noncoercively obtained wealth, the transfer would operate as an incentive for him to divert his energies from coercion to production. The result would be not only an increase in Robert's utility from what it was after the transfer, but his production would increase "social output" and, therefore, social utility. Moreover, if the transfer went to those who had originally earned the wealth, not only would it increase their utilities immediately, but keeping the rewards or gains from their production would, it is likely to assume, stimulate producers to expand their outputs, thereby increasing not only the utilities of the producers but social utility as well.

If we assume that Robert obtained his fortune voluntarily, the incentives created by wealth transfers are exactly reversed. The immediate effect of the

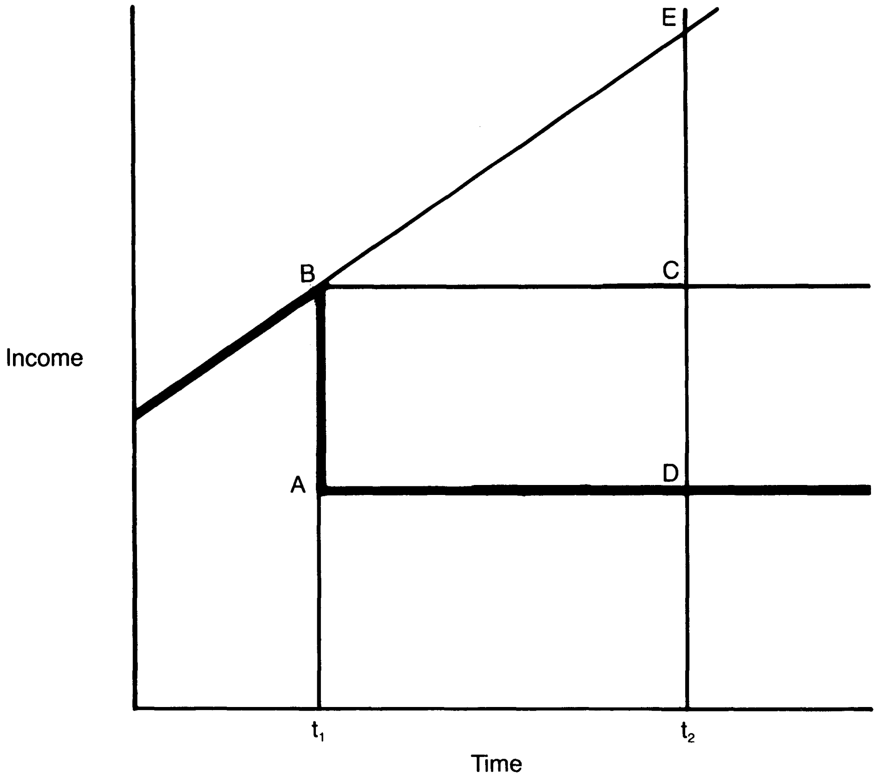

Figure 1. Robert

government transfer from Robert to Herb would be, as shown in figures 1 and 2, to reduce Robert's utility while increasing Herb's. But this is only the beginning of the process. How would Robert react to the continued appropriation of his earned income (the area *ABCD* in figure 1)? Put differently, how would he react to policies that prevented him from raising his utility beyond a certain level, say *A* in figure 1?

If Robert has obtained the highest utility plane possible under the circumstances, he would, of course, cease trying to increase his utility and rest content with simply maintaining it at the current level. This means that the transfer activities would, at time t_2, result in a discrepancy between Robert's realized income, *D,* and his counterfactual income, *E.* Moreover, it means that society as a whole would be impoverished by the loss of Robert's production equal to the area *BCE.*

The wealth transfer is likely to have an equally significant impact on

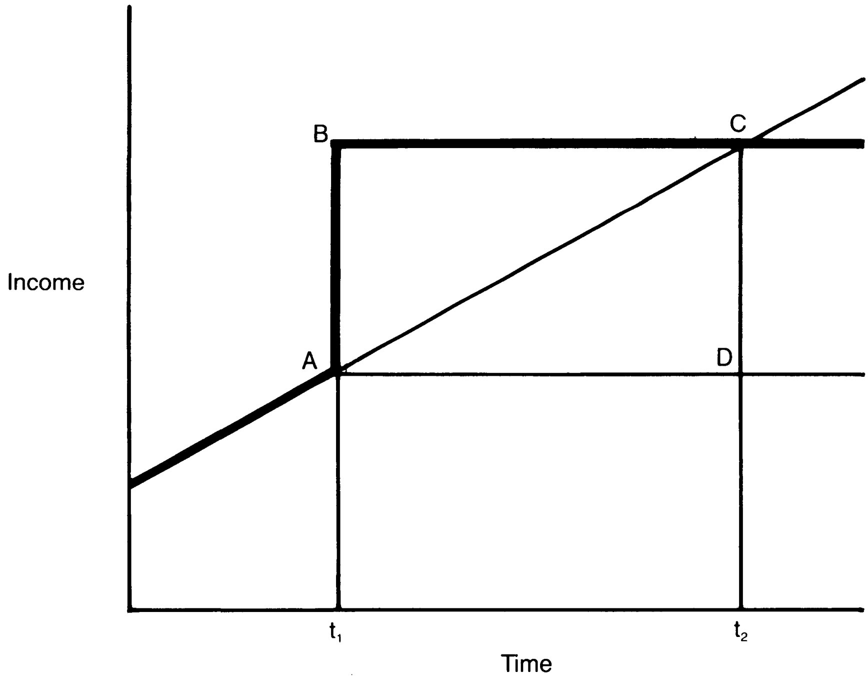

Figure 2. Herb

Herb's behavior. Since the transfer brings about an immediate increase in Herb's income from *A* to *B* (in figure 2), and since Herb knows that the government will not permit his income to drop below that level, it is obvious that it would reduce, perhaps even eliminate, his incentive to produce. So long as Herb's earned income falls below *B*, his work is simply wasted effort on his part. That is, since work is a disutility, any work yielding an income at or below line *BC* would reduce Herb's utility since he could obtain the same or greater wealth without work. Thus, the transfer means that Herb would be better off by reducing the hours he works or by not working at all. If, for simplicity, we assume that Herb reacts to the transfer, like Robert, by maintaining his earned income at his current level (*A* in figure 2), the transfer, represented by the area *ABCD,* increases Herb's income at time t_1. At time t_2, his total income (earned income plus transferred income) is C. But this is the *same* income that he *would be enjoying* had he not received any transfers in the first place. Hence, other things being equal, Herb is no better off at t_2 with transfers than he would have been in their absence; and "society" is poorer to the extent of Herb's lost production, i.e., the area *ACD* in figure 2.

The result is interesting. The government transfer hurt Robert. On the other hand, it did not benefit Herb, at least in the *long run*. Since no one was benefited and at least one person was hurt, the transfer "benefits" actually *reduced* social utility in this case.

One possible counterargument is that both Robert and Herb simply exchanged more leisure and a smaller income for a larger income with more work, and, since leisure is a valuable good which contributed to one's utility, neither has had their utility levels reduced. We are constantly making incremental adjustments between leisure and wealth. But it is important to recognize that if one's preferred option is additional wealth and if this option is coercively barred, then even if additional leisure is the best of the remaining options, it still represents a decline in utility. If there is a reduction in the overall economic growth rate in a particular country and if that reduction can be traced to government policies, it is clear that most if not all of that government's citizens would have preferred the additional wealth. This, of course, would be especially true if the slowdown resulted from declining productivity and therefore produced little if any additional leisure. Recent empirical studies (see, e.g., Landau; Olson; and Krauss, especially pp. 157–60), provide some indication that this, in fact, is the case.

Similarly, if economic output increases following a reduction in government regulation, one can conclude that all or most members of the society preferred additional income to leisure and that enforced leisure, provided there was some, meant that the members' realized utility was below their counterfactual utility. The dramatic increase in agricultural output in those third world countries that have recently reduced government interference in the agricultural sector compared to the continued low or even declining outputs of those countries with prohibitive taxes on and extensive government involvement with agriculture indicates that low economic output does not represent a preference for leisure over wealth (*The Economist;* Osterfeld, 1985a; *Time;* and Francis).

One can also argue that there is no reason that long-run interests should take precedence over short-run interests. But it is a serious mistake to phrase the issue in this way. Individuals maximize their utility by making trade-offs "at the margins." They choose to consume X units of good A, $X + 1$ units of good B, and $X - 2$ units of good C, etc. In similar fashion, individuals maximize their utility by choosing to satisfy some desires in the present, others at $t + 1$, and still others at $t + n$. One may choose to eat a hamburger now, buy an automobile next year, and go to college in ten years. We live in both the present and the future. We are constantly making trade-offs between satisfying certain desires now and satisfying other desires at various times in the future. The important point is that if one is to choose the optimal mix of present and future satisfactions, the "rules of the game" should not be rigged so as to encourage or even induce individuals to behave in the short run in ways that produce long-run results that even the actors themselves would disapprove of. For example, a 100 percent tax on all production would, it is fair to assume, eliminate all productive behavior. This would be the result even though the consequences would be (a) easy to foresee and (b) those that everyone would disapprove of. In short, the tax would induce or *trap* people into behaving in the short run in ways that would produce in the long run results which they not only could predict but would regard, *even at the time of their choices,* as undesirable or irrational. Whether or not a choice is rational depends on both the goals and values of the individual making the choice and the context within which the choice is made. It is possible that *within a given context,* the most rational choice open to individuals has consequences that even they would regard as "irrational," i.e., counter to their own preference rankings. There is increasing evidence that government tax policies, transfer payments, and the like place individuals within decision-making contexts of this type.

There is, for example, substantial evidence that the Great Society and War on Poverty programs of the 1960s not only failed to eliminate poverty in the United States but actually led to an increase not only in the number but in the percentage of poor. In trying to explain this phenomenon, Charles Murray (p. 9) pointed out that "A government's social policy helps set the rules of the game—the stakes, the risks, the payoffs, the tradeoffs, and the strategies for making a living, raising a family, having fun, defining what 'winning" and 'success' mean. . . . The most compelling explanation for the marked shift in the fortunes of the poor," from the mid-1960s on, says Murray,

> is that they continued to respond, as they always had, to the world as they found it, but that we . . . had changed the rules of their world. . . . The first effect of the new rules was to make it profitable for the poor to behave in the short term in ways which were destructive in the long term. Their second effect was to mask these long term losses—to subsidize irretrievable mistakes. We tried to provide more for the poor and produced more poor instead. We tried to remove barriers to escape from poverty, and inadvertently built a trap.

Numerous other studies, both of the United States (see, for example, Gwartney and McCaleb; Gallaway and Vedder; Lee; Osterfeld, 1980) and of foreign nations (Lee; Kraus, Bauer, Bauer and Yamey; Sowell, 1983; Osterfeld, 1982; Osterfeld, 1985a; Osterfeld, 1985b, Bandow), reached much the same conclusions: government transfer programs, tax policies, and the like make it rational for the poor to choose options that will retard or even reverse their economic development, i.e., it induces individuals to make choices counter to their *own* preferences.

There is one remaining but vitally important question: how long would it take for natural economic growth to put someone like Herb on a higher utility plane than he was on after the receipt of the income transfer? This cannot be stated with certainty. It depends on many factors such as the size of the benefits received by Herb and the overall disincentive impact of income transfers.

Nevertheless, some rough assessments can be made. Norman Macrae (p. 20) has shown that between the year 1 A.D. and 1776 (the date of publication of Adam Smith's *Wealth of Nations*), average per capita income remained fairly constant at about $250 (in 1975 dollars). The percentage of mankind living below the poverty level was 99 percent. Today, that percentage is considerably less than 65 percent. Since world population has increased sixfold during this time, this represents an *eightyfold* increase in world output in the two-hundred—year time span between 1776 and 1975.

If one uses more current data, Landau (p. 460) has shown that the annual growth rate of per capita GDP for the sixteen most developed market economies averaged 6.3 percent for the 1955–73 period. The average share of government was 27 percent in 1955, but rose to 43 percent by 1979. Interestingly, the average economic growth rate for the sixteen countries dropped to a mere 2 percent during the 1973–79 period. Landau's rather cautious conclusion (p. 473) is that "the growth of government consumption and investment expenditure has helped 'cause' the slowdown in economic growth."

If, then, one assumes that 6.3 percent is the *normal* growth rate for a free market economy, per capita output would double every eleven years. This means that if transfers increased Herb's income by, say, a relatively modest 33 percent, his realized income, even with transfers, would fall *below* his counterfactual income in less than four years. If growth rates were faster, which seems likely since the 6.3 percent growth rate occurred while government was consuming 27 percent of the GDP, the time frame would be even shorter.

Thus, there is good reason to believe that government transfers actually reduce "beneficiary" income over even relatively short periods of time. And since the evidence also shows that the vast majority of people prefer more wealth to less wealth, it is reasonable to conclude that government transfers from rich to poor reduce the intrapersonal utility of all involved including the recipients.

Conclusion

The market process, provided it operates within a legal framework that internalizes externalities, operates so as to perpetually increase the utilities of all participants. In contrast, government intervention reduces social utility.

This can be demonstrated with certainty when utility is interpreted in ordinal terms. Although nothing can be said with certainty when utility is interpreted in cardinal terms, we have found no convincing evidence that any government transfers ever increase social utility, but considerable evidence that they reduce it. In short, the best available evidence indicates that government transfers inevitably reduce social utility regardless of whether that concept is interpreted in ordinal or cardinal terms.

It may be objected that only government transfer policies have been considered and that other government policies may have very different effects. But the fact is that there are no "other" policies. All government policies transfer wealth either explicitly or implicitly. Minimum wage rates, for example, "represent an implicit transfer *within the least advantaged classes,* from the most unskilled workers (who can no longer get any sort of job) to the best unskilled (who are integrated relatively more easily into the labor market). In the last analysis it is a regressive social measure" (Lepage, p. 122), i.e., it is an upward transfer of wealth.

Recognition of this significant but often overlooked fact has profound ramifications. For, if *all* government policies transfer wealth and if all the available evidence shows that transfers reduce social utility regardless of whether that term is interpreted in ordinal or cardinal terms, then the inescapable conclusion is that, based on social welfare criteria, government is an unjustifiable institution. Yet, even such insightful and normally courageous Austrians as Mises and Hayek have stopped short of pushing their analyses to their logical conclusions. Mises, for example, noted that since there will always be antisocial individuals, the preservation of social order necessitates the use of violence to crush such peacebreakers. Thus, the state is *sine qua non* of any tolerable social order (Mises, pp. 148–49). Unfortunately, since Mises, much like John Locke three centuries before him, never entertained the notion that police and court services could be supplied competitively, he ignored the anarchist implications of his own analysis and inconsistently advocated a (minimal) state.

More recently, several authors have investigated the possibility that police and court services might be supplied competitively and have concluded not only that this would be feasible but that it would be *desirable* as well. It is no accident that the most notable of these is Mises' protege Murray Rothbard (see Rothbard, 1970b; Rothbard, 1973. Also see Perkins and Perkins; Tannehill and Tannehill; Tuccille; Friedman; Sanders; and Osterfeld, 1986).

Notes

1. Whether one wishes to admit as evidence conclusions based on such relaxed or weak assumptions is another question altogether.

2. Adam Smith (1969, pp. 3–5) reaches much the same conclusion:
As we have no immediate experience of what other men feel, we can form no idea of the manner in which they are affected, but by conceiving what we ourselves should feel in the like situation. Though our brother is upon the rack as long as we ourselves are at our ease, our senses will never inform us of what are his sensations. . . . By our imagination we place ourselves in his situation, we conceive ourselves enduring all the same torments, we enter as it were into his body, and become in some measure the same person with him, and thence form some idea of his sensations, and even feel something which, though weaker in degree, is not altogether unlike them. . . . Whatever is the passion which arises from any object in the person principally concerned, an analogous emotion springs up, at the thought of his situation, in the breast of every attentive spectator.

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