New Direction
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SPENDING OTHER PEOPLE'S MONEY

A CRITIQUE OF RAWLS, PIKETTY AND OTHER REDISTRIBUTIONISTS

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INTRODUCTION

The Ten Commandments which Moses brought down from Mount Sinai thousands of years ago are mostly in the form of explicit, narrow prohibitions rather than direct orders. We are told not to kill, or steal, or give false evidence against our neighbours, or set our heart on their property.[1] This leaves us at liberty to do other things not prohibited in the Commandments, such as choosing what we say to, or about, our neighbours (provided we do not give false evidence against them) and such as exchanging our property, house, land, livestock or whatever else we may possess for something we want from our neighbours (where of course they have the same right to accept or reject the proposed transaction as we). But Chicago economist and Nobel Laureate Milton Friedman sometimes remarked that an eleventh commandment should be added and that it ought to be: "Thou shalt not do good with other people's money."[2]

There seems indeed to be little limit to people's goodness when it does not cost themselves anything. Even if they may not covet their neighbours' property for themselves, they want to apply government power to seize it from them in order to use it for all kinds of purposes or pursuits they consider noble and worthy, not least for redistribution from the rich to the poor, but also for subsidising various activities, such as opera houses in big cities or quaint lifestyles in remote areas. In this report, commissioned by the Brussels think tank New Direction, I argue, however, that for most purposes it is immoral and unjust to spend other people's money, even if a case can certainly be made for taxation to finance widely accepted functions of government, such as upholding law and order, maintaining a strong and effective defence force and taking care of those who cannot look after themselves and who have nobody on whom to rely except the community.

I begin this study by trying to establish that there is indeed such a thing as other people's money: that most people in most countries are entitled to what is registered as their property. In order to do so, I give a short account of the discussions by Locke and other philosophers about justice in initial acquisition. My contention is that land and other resources can be justly appropriated if and when others are not made worse off by it. I then turn to some passages on wealth and poverty in the Holy Book and argue that they are often misunderstood: they provide no justification for coveting and seizing your neighbours' property if the purpose is redistribution in one way or another, for example from the rich to the poor. The Good Samaritan was spending his own money.

I move on to the philosophical foundations of the modern welfare state found in Hegel whose ideas were first implemented in Bismarck's Germany and then perhaps most comprehensively in Sweden. I note that the social integration and inclusion desired by Hegel sometimes may be achieved by spontaneous cooperation. Whereas the Nordic countries are often invoked by redistributionists, in particular Sweden, I argue that their prosperity is *despite*, and not *because of* redistribution and that it can be attributed mainly to the rule of law, free trade and social cohesion coupled with a high level of trust, brought about by the relative homogeniety of Nordic societies, with their long, shared history.

I briefly analyse what is perhaps the most sophisticated attempt in our time to justify the redistributive state, John Rawls' theory, finding his rejection of self-ownership and belief in the existence of a collective fund ready to be distributed unpersuasive and impractical. His theory was really of prudence rather than justice: it was a strategy adopted by risk-averse individuals against potential adversity. For the sake of argument, I try to apply Rawls' maximin rule—aiming at the best possible standard of living for the worst off—to the modern world, concluding that even on his premises capitalism seems acceptable. Then I turn to the recent call by French economist Thomas Piketty for worldwide redistribution of income, not so much in order to lift up the poor as to bring down the rich. For Piketty, unlike Hegel and Rawls, wealth seems to be the social evil, not poverty. I point out that poverty has been greatly reduced in the last few decades and that new money has largely replaced old money amongst the rich so that Piketty's narrative of a runaway accumulation of inherited capital becomes implausible. I argue that the much maligned rich perform some useful functions without necessarily intending to do so. Some of Piketty's data on increased inequality of income and wealth may also be flawed.

After digressing on two nineteenth century novelists, Honoré de Balzac and Jane Austen, demonstrating that their message is quite the opposite of what Piketty believes, I point out that both he and Rawls have to insist on their redistributive programmes being implemented in a closed society because otherwise they could be made unsustainable, for example by the exodus of the rich. The two redistributionists have, in other words, to outlaw tax competition and stipulate 'Socialism in One Country'. I also submit that the most serious inequality in the world today is between those who are born in free and prosperous societies and those who live elsewhere and face limited opportunities to escape poverty. In writing this report I have benefitted much from lively discussions at meetings of the Mont Pelerin Society, an international academy of liberal and conservative scholars, of which I have been a member since 1984, and from many colloquia held by Liberty Fund, an institution devoted to the calm and reasoned discussion of fundamental social problems.

Reykjavik, 1 December 2018.
Hannes H. Gissurarson

1 Exodus, 20:1–17.

2 Another formulation, somewhat less biblical in style, is: "Everyone shall be free to do good at his own expense."

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IT IS OTHER PEOPLE'S MONEY

Money is the medium we use when we exchange goods or services in the market. What matters is of course what can be bought for money, not money itself. It is easy to demonstrate, even if not always well understood, that proper market exchanges, excluding fraud and coercion, work for the benefit of everybody concerned. For simplicity's sake, assume that Robinson Crusoe and Man Friday are the only inhabitants on an island and that they only need two kinds of goods to have a decent life, fish and coconut, and that the units of these goods are equivalent. Also, Crusoe is better at fishing and Friday at collecting coconuts: If Crusoe devotes his entire working hours to fishing, he will bring in eight fish, and Friday only four. Likewise, if Friday devotes his working hours to collecting coconuts, he will bring in eight of them, and Crusoe only four. On these premises, if Crusoe has to be self-sufficient, he will bring in three fish and three coconuts, and so will Friday. The total production on the island will be 12 units, six fish and six coconuts. If the two of them however hit upon the division of labour, and trade with each other, they will increase total production to 16 units, eight fish and eight coconuts, or, perhaps more likely, they will devote less time to production, keeping it down to 12 units, and spend more time on other more pleasant things. This is the basic explanation Adam Smith offered in the eighteenth century for the wealth of nations: division of labour and free trade, not least across borders.[3]

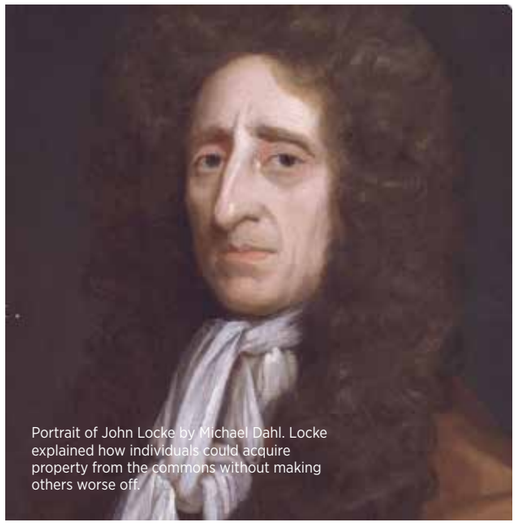
While Smith's argument for free trade has been widely accepted, the other basic tenet of the free market order has often been questioned: private property rights to goods produced by the exclusive access of some to natural resources and other means of production. For example, Samuel Brittan, a knowledgeable British commentator on current affairs, sympathetic to the free market, writes:

> "We badly need a conception of liberty and individual rights which will provide protection against the proclivities of a temporary majority for trampling over the rights and liberties of the rest of us in the name of a debased kind of act utilitarianism. Unfortunately all the well known variations of libertarianism and limited state conservatism—Nozick, Hayek, Oakeshott et al.—lack a theory of legitimate property rights, without which they are powerless to provide a comprehensive theoretical defence against collectivism, and we have to fall back on vaguer notions of a sufficiently large 'protected area' for the individual.[4]

Brittan is right that we need a theory of legitimate property rights. We can hardly complain that some people are spending other people's money if we cannot show that the money in question belongs in fact to those other people.

It is my contention that a robust theory of legitimate private property rights is provided by John Locke, as reinforced and refined by American philosopher Robert Nozick, while David Hume and Friedrich von Hayek have given plausible answers to the different but equally weighty question why private property rights are necessary. Locke starts by stating that God gave the world to men in common, for the support and comfort of their being. This means that in the beginning there was no private ownership of any goods, but just as importantly for our purposes, that there was not any public ownership, either. Things were simply unowned; the earth was one big commons. However, every man has a property in his own person: the labour of his body and the work of his hands are properly his. He is not a slave, owned by others. This means that he can remove things out of the commons and by mixing his labour with them, they become his property. Locke adds an important proviso, "at least where there is enough, and as good, left in common for others."[5] Locke says that since things are unowned, but intended by God to be used, man does not need the express consent of all the commoners to appropriate things, only the proviso. Nozick plausibly argues that Locke's proviso should be revised: People can appropriate things out of the commons if others are not *made worse off* by the appropriation, in other words if they are fully compensated for the things that have been removed by others out of the commons.[6] Locke adds another proviso that nobody can remove so much out of the commons that it would become spoiled or destroyed by not being used. He notes, though, that this proviso becomes irrelevant with the invention of money, as things can be exchanged for money. (It is also not clear whether he really needs the latter proviso to begin with; the former proviso would seem to cover the eventuality he mentions.)

Having described how man can remove things such as deer or acorn out of the commons, by hunting or gathering, Locke moves on to land. He says that man can appropriate land in the same way as other things in commons, by working on it. "He by his labour does, as it were, inclose it from the common."[7] The proviso still applies: others should not be made worse off by the appropriation. Undoubtedly it would seem to some that Locke here gets into real difficulties. Is the amount of usable land not more or less fixed, so that the more one appropriates the less there is left for others? Thus, are they not obviously made worse off? Not at all, according to Locke and, later, to Nozick. While the *expanse* of usable land may be more or less fixed, its *yield* is not: It is highly variable. By enclosing land, it becomes much more productive which indirectly compensates all those who do not gain ownership over the particular plot of land enclosed. Locke observes that "he who appropriates land to himself by his labour, does not lessen, but increase the common stock of mankind: for the provisions serving to the support of human life, produced by one acre of inclosed and cultivated land, are (to speak much within compass) ten times more than those which are yielded by an acre of land of an equal richness lying waste in common."[8] Locke adds that of the total income of a society most is anyway created by labour, not by titles to parcels of land. By appropriating natural resources, their initial owners put them to much better use than otherwise would be the case, and with the vastly increased yield from it, leading to increased demand for other services, they create opportunities for those latecomers who found everything already being appropriated, and these opportunities compensate, or more than that, for the resources being removed out of the commons.



Portrait of John Locke by Michael Dahl. Locke explained how individuals could acquire property from the commons without making others worse off.

Some people find it implausible that the increased productivity of an economy where resources are fully appropriated could compensate for the goods removed out of the commons. One of my teachers at Oxford, David Miller, was for example a 'market socialist'. He could see the case for free trade, such as that between Robinson Crusoe and Man Friday mentioned above, where both of them obviously benefitted from their division of labour. But he once told me that in a private property rights system he would be worried about the latecomer arriving when everything had been appropriated: Was that person not being done down? I replied that an immigrant to the United States in 1950 could expect a much better life, with many more opportunites, even if almost all resources then were privately owned, than somebody who came to North

3 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* [1776], Vols. I-II (Indianapolis IN: Liberty Fund, 1982).

4 Samuel Brittan, *The Role and Limits of Government. Essays in Political Economy* (London: Temple Smith, 1983), p. 41.

5 John Locke, *Two Treatises of Government* [1689], Second Treatise (Cambridge: Cambridge University Press, 1960), Ch. V, §27.

6 Robert Nozick, *Anarchy, State, and Utopia* (Oxford: Blackwell, 1974), p. 176.

7 Locke, *Second Treatise,* Ch. V, §32.

8 Ibid., §37.

Portrait of David Hume by Allan Ramsay. Hume explained how private property rights developed as a response to scarcity and limited altruism.

America in 1650 when most resources were available for initial appropriation. By Locke's assumptions, certainly nobody was entitled to a *particular* plot of land: therefore, he was not made worse off by somebody else appropriating that plot of land if he was compensated for this move by other opportunities of using the things Locke believed God had put at our disposal, for our support and comfort of being.

There are several reasons why private property rights, not only in land, but also in other means of production, tend to increase productivity and create new opportunities.[9] First, there is the familiar argument that people take better care of resources if they directly benefit from doing so, whereas "Everybody's business is nobody's business," as British historian Lord Macaulay said.[10] In the second place, in market transactions capital, including factories, business firms and natural resources, will be transferred in a dynamic process from the less to the more efficient: because some capitalists and entrepreneurs make a profit, they will remain in business whereas others who make one mistake after another and who consequently suffer persistent losses, eventually will go bankrupt.[11] Yet another reason is that if different individuals own and control separate resources, more experiments will be undertaken which leads to faster economic growth. One thousand venture capitalists, each with one million dollars to spend on new ideas at their own risk, will make at least one thousand experiments whereas a state fund for innovation, disposing of one billion dollars, will be governed by a board of five to ten people who, however well-intentioned, will probably be cautious and only willing to invest in a few projects. In fact, the majority on such a board might be better in picking losers than winners.[12] Fourthly, if different individuals own and control separate resources, they will be able to decide on the pattern and types of risks they wish to bear.[13] Yet again, private property rights enable people to take the future into account: if you reduce your current consumption in order to make an investment such as improving your land, then you know that its price will go up, whether you sell it tomorrow or after a decade.

It should be emphasised that these economic considerations do not imply that Locke's and Nozick's defence of justice in initial acquisition is utilitarian. On the contrary, it is an argument from liberty: It is that your appropriation of resources, removing them from the commons, is not unjust if nobody is made worse off by it which means that the equal right of others to appropriate is not being infringed by your appropriation. Economic considerations as those mentioned above enter into Locke's and Nozick's essentially moral argument to demonstrate that indeed people who did not appropriate resources themselves were at least fully compensated by the creative powers of capitalism. Of course Locke and Nozick are also aware that many of the resources people hold today were initially appropriated by violent means, war, plunder and theft. But they could say, as they indeed both do, that most income is derived from one's labour and not from control of natural resources. This may be even more relevant today when knowledge, skill and expertise are crucial for success in the marketplace than it was in past centuries. Locke and Nozick could also say that even if the stories about plunder and theft are true there is little we can do about the past. After a certain time has lapsed, there is a statute of limitations on most crimes, and so it should be, for practical reasons, on people's holdings. This became relevant in post-communist Central and Eastern Europe where justified efforts were made to return to people property which the communists had illegally seized from their parents or grandparents: you could go back 40 or 50 years, but you could hardly go back 100 or 150 years.

The argument from liberty is not only that you can appropriate resources without infringing the rights of others, but also that property in general tends to support liberty, and is indeed required by liberty, as is clearly stated in the papal encyclal *Rerum novarum* of 1891:

> It is the mind, or reason, which is the predominant element in us who are human creatures; it is this which renders a human being human, and distinguishes him essentially from the brute. And on this very account—that man alone among the animal creation is endowed with reason—it must be within his right to possess things not merely for temporary and momentary use, as other living things do, but to have and to hold them in stable and permanent possession; he must have not only things that perish in the use, but those also which, though they have been reduced into use, continue for further use in after time.[14]

Private property rights provide stability and enable individuals to make meaningful choices about their futures. Economists might add the consideration that unpopular individuals or minorities can in a society of dispersed ownership usually find employment somewhere, or create it for themselves: they do not have to convince any one person or small group of hiring them.[15]

Adam Smith observed that perhaps initial acquisition does not make much of a difference:

> The produce of the soil maintains at all times nearly that number of inhabitants which it is capable of maintaining. The rich only select from the heap what is most precious and agreeable. They consume little more than the poor, and in spite of their natural selfishness and rapacity, though they mean only their own conveniency, though the sole end which they propose from the labours of all the thousands whom they employ, be the gratification of their own vain and insatiable desires, they divide with the poor the produce of all their improvements. They are led by an invisible hand to make nearly the same distribution of the necessaries of life, which would have been made, had the earth been divided into equal portions among all its inhabitants, and thus without intending it, without knowing it, advance the interest of the society, and afford means to the multiplication of the species. When Providence divided the earth among a few lordly masters, it neither forgot nor abandoned those who seemed to have been left out in the partition.[16]

It matters much more, Smith thought, that private property rights in land, or other natural resources and means of production, are well-defined and easily transferable than who initially acquires them, because in voluntary, uncontrolled transactions holdings will anyway end up in the hands of those who value them the most.

While Locke taught *how* appropriation of the world's resources could be just if nobody would be made worse off by it, Hume explained *why* private property rights exist in the first place, arguing

> that justice takes its rise from human conventions; and that these are intended as a remedy to some inconveniencies, which proceed from the concurrence of certain qualities of the human mind with the situation of external objects. The qualities of the mind are selfishness and limited generosity; and the situation of external objects is their easy change, joined to their scarcity in comparison of the wants and desires of men.[17]

If human circumstances were different, property rights would also be different, or perhaps not exist at all. They would for example disappear in a world where the generosity of men would be extensive and where

9 Cf. Nozick, *Anarchy,* p. 177.

10 Thomas Babington Macaulay, Hallam's Constitutional History, *Edinburgh Review,* Vol. 48 (September 1828).

11 Ludwig von Mises, Profit and Loss, paper at the Mont Pelerin Society meeting in Beauvallon, France, September 1951, repr. in *Planning for Freedom* (South Holland IL: Libertarian Press, 1952), pp. 108–150.

12 John Burton, *Picking Losers: The Political Economy of Industrial Policy* (London: Institute of Economic Affairs, 1983)..

13 Armen Alchian, Some Economics of Property Rights, *Il Politico,* Vol. 30, No. 4 (1965), pp. 816–829, repr. in *Economic Forces at Work* (Indianapolis IN: Liberty Press, 1977), pp. 127–149.

14 *Rerum novarum* (On Capital and Labour) 15 May 1891, *The Tablet,* Vol. 77 (23 May 1891). Available online.

15 Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), Ch. II.

16 Smith, *The Theory of Moral Sentiments* [1759] (Indianapolis IN: Liberty Fund, 1984), Part IV, Ch. 1, §10.

17 David Hume, *A Treatise of Human Nature. Books II and III* [1740] (London: Collins, 1972), Book II, Part II, Section 1, p. 224.

everything would be in abundance.[18] But for the very idea of justice to have any application in society as we know it, private property rights have to be fixed and comprehensive:

> But however single acts of justice may be contrary, either to public or private interest, it is certain that the whole plan or scheme is highly conducive, or indeed absolutely requisite, both to the support of society, and the well-being of every individual. It is impossible to separate the good from the ill. Property must be stable, and must be fixed by general rules. Though in one instance the public be a sufferer, this momentary ill is amply compensated by the steady prosecution of the rule, and by the peace and order which it establishes in society. And even every individual person must find himself a gainer on balancing the account; since, without justice, society must immediately dissolve, and everyone must fall into that savage and solitary condition, which is infinitely worse than the worst situation that can possibly be suppos'd in society.[19]

The gist of Hume's theory of property rights can, then, be captured in the old saying that 'Good fences make good neighbours.' This is also one of von Hayek's main arguments for private property rights: They facilitate the mutual accommodation of different individuals with conflicting aims, and thus they tend to maintain peace. A related argument advanced by von Hayek is that protected domains such as private property rights enable individuals to acquire and transmit knowledge essential for the spontaneous coordination of a complex economy.[20]

Locke and Hume and their intellectuals heirs thus conclude that there indeed is such a thing as other people's money. However, some beg to differ. Opponents of private property rights focus on the two facts that some owners of resources seem to reap without sowing and that private property rights by their nature imply exclusion of others by the owners. In nineteenth century Great Britain, not least in Scotland and Ireland, absentee landlords lived lavishly off the huge rent from vast stretches of land where their tenants eked out an existence. What had those proprietors done to deserve their comfortable and effortless lives? Also, when you fence off a plot of land or brand a drove of sheep, you inevitably are excluding others from the utilisation of these goods. Wherefrom do you acquire the right to exclude those people? Even two eminent liberal thinkers of the day, Herbert Spencer and John Stuart Mill, found private ownership of land problematic, at least ownership of land that you did not work on yourself. When land increased in value without any contribution by its owner, Mill famously spoke about 'unearned increment'.[21]

As a young man in Germany, philosopher Karl Marx had rejected private ownership of resources and become a communist by observing a controversy about forests in the Rhineland where he was briefly employed as a journalist. Poor people had long been able to go into the forests and to collect fallen branches of trees, using them as firewood. Now wood was becoming scarce as a result of industrialisation, and a law was passed prohibiting this past practice. Accordingly, the owners of the woodland were the only ones who could collect dead wood. Marx protested fiercely against the new law: The forest owners should be regarded as the real thieves, not the poor people who had simply been continuing a tradition: "Just as it is not fitting for the rich to lay claim to alms distributed in the street, so also in regard to these *alms of nature*."[22] In his main work, *Capital*, Marx thundered against the enclosure of commons which had taken place in Scotland and elsewhere in the United Kingdom over centuries.[23] His case against private property rights was twofold. First, they mostly had been acquired initially by plunder and theft. Secondly, capitalism, or the system of private property rights, split people into two classes, the Proletariat that had no property except their ability to work and the Bourgeoisie owning the means of production. Such a division brought about both the alienation (*Entfremdung*) and exploitation (*Ausbeutung*) of workers. Alienation was a process in which workers lose their humanity by becoming instruments in the hands of the Bourgeoisie, mere objects and not independent agents. Exploitation took place when the Bourgeoisie, controlling all means of production, took advantage of their superior bargaining position to force the workers to work much longer hours than was necessary for their upkeep, appropriating the 'surplus labour' thus created.

Marx' case against private property rights is however not strong. While some goods may initially have been appropriated by war, plunder and theft, Marx seems for example to have exaggerated the violence applied in British enclosures: They took place mostly by agreement, and vastly increased the total product from land.[24] After many generations things have more or less ended up in the hands of the same people as they would have done if there had been an orderly and just process, as Smith observed. Time heals most wounds and evens out irregularities, not least if we bear in mind that extensive redistribution in favour of the poor has been undertaken in most Western democracies for more than a century.[25] We could also ask whether such rights, under Marxist premises, would be legitimate if they indeed were acquired by some without worsening the situation of others, peacefully and with no plunder or theft. It would be somewhat ironic if Marxists would defend property rights so acquired. It does not seem to be the case, either, that workers, by selling their labour, lose their humanity and become mere objects, as the Marxist theory of alienation predicts. Workers and their employers exchange services, both parties to the exchange becoming better off as a result. When there is economic growth workers seem to gain more humanity by having to work fewer hours and being able to pursue all kinds of interests, although those may not always be the interests which intellectuals like Marx would like them to have. This is a point to which I shall return in Chapter 8.

Marxist exploitation was dependent on Marx' theory of value which modern economists generally reject. If 'surplus value' would be created by any work longer than required to reproduce the Proletariat, then both investment and contributions to non-workers such as pensioners would amount to exploitation of the workers, which is an implausible conclusion. Marx believed that since the Proletariat lacked access to the means of production it would not have any reserve funds on which to rely in wage disputes and that therefore it would have to accept the terms laid out by the Bourgeoisie. But nowadays this is not the case: employees have considerable reserve funds, both private and in common, and often have an upper hand in wage bargaining with employers. One can ask, also, if workers were really exploited by having to sell their labour to employers, why they have not then established more businesses themselves: it would not be more difficult for a workers' cooperative to obtain funding than for a small privately owned company. The answer is of course that there are not many people willing to take on the risk that inevitably is a part of establishing and operating business firms.[26] In Marx' theory, two groups whose operations are vital for progress are notably absent: venture capitalists and entrepreneurs.

Nevertheless the idea, broached by both Spencer and Mill, that some income is unearned and thus undeserved is resonant, as Georgism shows. Living in California in mid-19th century, Henry George, a self-educated economic commentator, noticed that the public did not seem to benefit when the price of land rose as a result of gold discoveries. It was only the landowners who benefitted, even if they had not contributed anything themselves. Therefore, George proposed that government should expropriate all land rent through a 'single tax', equal to the rent of land: the more fertile the land, the higher the tax. According to George, such a single tax had many advantages. First, it only applied to that part of income which landowners had not earned and which they therefore did not deserve. In the second place, such a tax, unlike many other taxes, would not reduce the incentive to work or diminish the total social product. It was applied to cultivated or cultivable land, which was in fixed or nearly fixed supply. The tax would not therefore affect supply, but it would ensure that

18 Ibid., p. 226.

19 Ibid., p. 227.

20 Hayek, *The Constitution of Liberty* (London: Routledge & Kegan Paul, 1960). Repr. as Vol. 17 in *The Collected Works of F. A. Hayek* (London: Routledge, 2011).

21 Herbert Spencer, *Social Statics* (London: John Chapman, 1851), Ch. IX; John Stuart Mill, The Right of Property in Land, *Examiner* 18 July 1873, pp. 725–728.

22 Karl Marx, Debatten über das Holzdiebstahlsgesetz, *Rheinische Zeitung,* 25, 27 and 30 October and 1 and 3 November 1842, repr. in Karl Marx and Friedrich Engels, Werke, Vol. 1 (Berlin: Dietz, 1956), pp. 109–147.

23 Marx, *Das Kapital. Kritik der politischen Ökonomie* (Hamburg: Otto Meisner, 1867), Ch. 24 [Ch. 27 in the English ed.], repr. in *Werke*, Vol. 23 (Berlin: Dietz, 1962), pp. 741–791.

24 Donald N. McCloskey, The Economics of Enclosure: A Market Analysis, *European Peasants and their Markets: Essays in Agrarian Economic History* (Princeton NJ: Princeton University Press, 1975), pp. 123–160.

25 Nozick, *Anarchy,* p. 231.

26 Ibid., p. 177.

landowners would not leave their properties unused. The tax would also hinder speculation in land. Thirdly, the single tax could replace most other taxes, even be sufficient for the needs of government.

While on first sight Georgism may appear plausible,[27] it has its problems. First, many farmers or other land users have paid the full price for their plots, even if other landowners may have seen a price rise without any efforts or improvements by themselves. It seems unfair to treat the two groups in the same way. In the second place, it is difficult or well nigh impossible to distinguish between the rent from natural, unimproved land on the one hand and the contribution to its value by landowners (for example their foresight and prudence or their reform of the land) on the other hand. The rent is the price of the land itself, but how can this price be found when each plot of land is different? Farmland close to a big city is worth much more than equally fertile farmland in a remote corner of a country. But how much of the additional price can be attributed to improvements on the plot, to its natural fertility, to its location and to the foresight of the owner (who perhaps successfully bet on a village growing into a city). Georgists seem to assume that the highest value of a plot of land, whether it is located in a city or the countryside, is always a known figure, making its taxation easy to accomplish. But the most profitable future utilisation of a plot of land is only discovered in the market process, as von Hayek would argue. Thirdly, George overestimated the possible revenue from a single tax. In any developed country, land rent is only a small part of the GNP, gross national product, frequently less than one-tenth of it.[28]

In what was intended to be a critique of initial acquisition under capitalism, American economist and Nobel Laureate Paul Samuelson may have strengthened Locke's and Nozick's case for private property rights. The tale Samuelson talls is illuminating. It is about a village inhabited by six workers and their families. The community holds in common two plots of land, A and B, different in quality on which the six men work, dividing the total product derived from it equally amongst themselves. But the crucial fact is that the two plots of land are of different fertility. Economic theory tells us that the total product from the land in question would increase if the superior quality of plot A would be correctly priced, or in other words if rent would be collected from it. Since this is not done, Samuelson rightly finds that labour will be allocated between the two plots in such a way that the workers' average income from both of them will be equal, whereas that allocation of labour would be more efficient whereby marginal income would be equal. In other words, where land is held in common and there are no charges for the utilisation of plots reflecting their different quality, the more fertile plots will be over-worked. There will be a loss in the form of a benefit foregone. Rent will be dissipated.

Thus, the enclosure of the commons worked on by the six villagers seems to be a desirable move. But Samuelson then argues that rent collection by a landlord, while increasing the total product, will bring down the wage level of the land workers. The reason is this: After the introduction of such rent collection, the workers would receive each the marginal income from the land, equal to the marginal income from the less fertile plot B, and this is lower than the average income from the two plots which they each had received previously, assuming an inelastic labour force and diminishing returns. While landlords certainly render a social service by collecting rent and thus increasing the total product from land, there is, Samuelson suggests, some merit in the Marxist contention that enclosures of commons had worsen the conditions of the working class. "Under the conditions postulated, the rent collected by landlords always represents more than the extra output society thereby achieves", Samuelson writes, "so in a certain sense, rent collection subject to no tax represents a subtraction (if not 'exploitation') of labour."[29] Thus, the rent-collector is not worthy of his full hire, Samuelson concludes. A tax on the rent collected by landlords which would then be redistributed to land workers seems justified. The money is not his.

Samuelson's whole approach is however odd. In his tale, there is a much simpler way of solving the problem of over-utilisation than a special tax on landlords. This is to define private property rights to

27 Friedrich von Hayek, for example, comments that it is the "theoretically most defensible of all socialist proposals", *Hayek on Hayek: An Autobiographical Dialogue* (Indianapolis IN: Liberty Fund, 2008), p. 63.

28 David Friedman, *The Machinery of Freedom* (New York: Harper & Row, 1973), pp. xiv and xv.

29 Paul A. Samuelson, Is the Rent-Collector Worthy of His Full Hire? *Eastern Economic Journal,* Vol. 1, No. 1 (1974), pp. 7-10. Words quoted on p. 7.

Economic growth makes possible individual appropriation without harm to others. Photo: Foundation for Economic Education.

the land on the basis of utilisation history (a principle of allocation alternatively called first occupancy or 'grandfathering').[30] The six inhabitants in the village would each be given one-sixth of plot A and one-sixth of plot B, since they are utilising the two plots equally. Then it would be brought about spontaneously, in the marketplace, that the two plots of land would be worked on in accordance with their different quality. The six workers in the village would each derive as much or more income from the land than previously, while the total product would, over time, increase. (If some would not utilise the land as efficiently as others, their plots of land would sooner or later be bought by those others.) It is difficult to see wherefrom Samuelson's landlord suddenly arrives to appropriate the land previously owned in common by the villagers. Samuelson is of course right that those who owned plots of land in common and who worked on them, would probably see their conditions worsen if a stranger suddenly arrived to take this land away from them, even if the total product from land would as a result of this enclosure increase. But the real conclusion to be derived from his analysis is that it does not only matter that total product is increased by an enclosure. It is also crucial that the enclosure takes place in such a way that particular people are not made worse off from it which is precisely the proviso on which Locke insisted.

Perhaps Samuelson also should have paused to compare a common-property village and a private-property village. In the common-property village only one-sixth of the income of each person would be derived from his own contribution which might create a temptation to shirk, and that temptation would be strengthened as the number of his co-workers would increase. In the private-property village all of the income of each worker would be derived from his own contribution. Moreover, there is the question of innovation. In the common-property

30 Samuelson indeed recognises this possibility in a footnote, p. 8.

village a potential innovator would have to convince the other five villagers of his idea, for example to replace cropland by pastures on some plot of land. In the private-property village each would be free to make his own experiments with his own land. These considerations would serve to strengthen Locke's argument that the creative powers of capitalism more than make up for the fact that by initial acquisition resources are removed from the commons. It should also be noted that the revised Lockean proviso, that nobody should be made worse off by your appropriation of a resource, is logically equivalent to the more modern idea of a Pareto-optimal social change: after such a change everybody should be better off or at least not worse off.[31] Both criteria or conditions reflect the 'Golden Rule' of the full and equal freedom of all: Your freedom is only restricted by the same freedom of others.[32]

Land covers about 30 per cent of the earth's surface. The rest is the ocean which was according to Locke "that great and still remaining common of mankind".[33] Fishing grounds are some of the ocean's most valuable resources. Economists have cogently described how the rent which could be derived in the fisheries would be dissipated if fishing grounds of different fertility would not be priced in accordance with their fertility, just like what happened to Samuelson's plots of land. Fishing effort would increase to the point when total revenue would be equal to total cost, instead of ending up at the much lower point when the difference between revenue and cost, or in other words profit, would be the greatest. The reason for this was open access.[34] In late twentieth century, my country of origin, Iceland, however developed a solution to this problem. It was to enclose the fishing grounds in Icelandic waters by allocating individual transferable quotas to fishing firms for different fish stocks harvested there. Those quotas were initially allocated by catch history (or 'grandfathering') and then made transferable. If your fishing firm had caught 10 per cent of the total allowable catch in a certain fishery, you received a quota of 10 per cent, which you could either hold on to or sell, while you could also buy quota from others. Thus, if the total allowable catch over the fishing season was set at 100,000 metric tonnes, then you could harvest 10,000 tonnes. If the total allowable catch was reduced to 90,000 tonnes, for example because the stock in question was deemed not to be robust, then you could harvest 9,000 tonnes.

The introduction of the system of individual transferable quotas in the Icelandic fisheries amounted to an enclosure. It was a move from open access to exclusive rights, and it had the desired impact: the more efficient fishing firms bought quotas from the less efficient firms which subsequently ceased to operate, and fishing effort gradually fell down to the level where profit could be made. The waste consisting in too much fishing effort was largely eliminated. Rent which previously had been dissipated was now being captured. The owners of fishing vessels became custodians of the fish stocks, supporting a cautious setting of the annual total allowable catch for each fish stock.[35] The change has been a success. The Icelandic fisheries are sustainable and profitable, unlike fisheries in many other countries.[36]

The initial allocation of quotas was however criticised by some Icelandic left-wing intellectuals because it meant that the quota holders gained a right to exclude others from harvesting fish.[37] This is a right which became quite valuable over time. Was this not the 'unearned increment' that the young Spencer, Mill and George worried about? Did the quota holders not receive a precious gift from the legislator? Why could they exclude others? But in fact the initial allocation fulfilled the Lockean proviso. Nobody was made worse off by it. The only right others were deprived of was the right to harvest fish under an open-access regime and, as fisheries economists had demonstrated, this was a right to harvest fish at no profit, so it was a right of no value. Putting it differently, the change was

The adoption of the Icelandic system of individual transferable quotas in the fisheries, making fish stocks exclusive resources, made nobody worse off.

Pareto-optimal. The critics proposed another way of closing access, a government auction of the quotas. But this would have meant that some people would have been made worse off, namely those who would not have been able to buy quotas. They would have seen their physical and human capital, accumulated over years and decades, vanish overnight. The change would not have been Pareto-optimal. Under the present Icelandic regime, on the other hand, owners of the superfluous fishing capital were gradually *bought out* in market exchanges, not suddenly *driven out* by government (by inability to bid for quotas). Nobody received a gift in the sense that something of value was transferred from one party to another: The rules were changed in such a way that value could be created in the fisheries.

Our main conclusion would therefore be, with Locke and Nozick, that there is no reason to reject as unjust the distribution of wealth and income in a free market order which is based on private property rights and which has been allowed to operate over centuries. The money ordinary, law-abiding citizens hold under such an order is theirs and theirs only. It is at their disposal. We do not have a claim on it in the name of justice.

31 James M. Buchanan, Positive Economics, Welfare Economics, and Political Economy, *Journal of Law and Economics,* Vol. 2, No. 1 (1959), pp. 124–138. Repr. in *The Collected Works of James M. Buchanan*, Vol. 1 (Indianapolis IN: Liberty Fund, 1999), pp. 191–209.

32 Karl R. Popper, Public Opinion and Liberal Principles, Lecture at the 1954 meeting of the Mont Pelerin Society in Venice. Repr. in *Contectures and Refutations* (London: Routledge & Kegan Paul, 1974), pp. 350–351.

33 Locke, *Second Treatise,* Ch. V, §30.

34 H. Scott Gordon, The Economic Theory of a Common-Property Resource: The Fishery, *Journal of Political Economy,* Vol. 62, No. 2 (1954), pp. 124–142.

35 Hannes H. Gissurarson, *The Icelandic Fisheries: Sustainable and Profitable* (Reykjavik: University of Iceland Press, 2015).

36 Ragnar Arnason et al., *The Sunken Billions Revisited: Progress and Challenges in Global Marine Fisheries* (Washington DC: World Bank, 2017).

37 E. g. Stefan Olafsson, From Statism to Neoliberalism and Financial Collapse, *The Nordic Varieties of Capitalism* (Bingley: Emerald, 2011), p. 18.

3

A STORY AND A PARABLE FROM THE BIBLE

There are those who try to enlist Christianity in their pursuit of other people's money, quoting exhortations by Jesus to the rich to share their wealth. Those commentators seem however to be profoundly mistaken about the nature of Christianity. The main political difference between it and Marxism is that Christians seek *personal* salvation, each in his or her own way, even if it may be through a church, whereas Marxists try by *collective* action of government to enforce the salvation of society. Thus, Christianity is by its very nature anti-totalitarian, if totalitarianism is defined as the attempt to subdue both body and soul and to draft everybody into an army marching on to a radiant future. Indeed, the strongest resistance to twentieth century totalitarianism in Central and Eastern Europe, whether national socialism or communism, came from the churches.[38] Christians recognise the fundamental difference between the spiritual and the secular, the sacred and the profane. Jesus said: "Pay Caesar what belongs to Caesar — and God what belongs to God."[39] This is in contrast to some other religions.[40] For example in Islam, a caliph is both a civil and a religious leader and the designated successor to Muhammad who was a warrior prophet galloping on a horse. Jesus also stressed that man is master of the Sabbath, not the other way around.[41]

The story in the Bible about John the Baptist is sometimes invoked to justify enforced redistribution. When he said to the crowds who came to be baptised by him that they should produce good fruits as evidence of their repentance, the crowds asked him what they should then do. John the Baptist replied: "Anyone who has two tunics must share with the one who has none, and anyone with something to eat must do the same."[42] There are several things to note about this advice. First, if nobody is around with two tunics, then there is nothing to share, a point to which we shall return later in this chapter. In the second place, we must ask *why* an individual has come to lack a tunic. If it is through sloth, one of the seven capital sins, then there is little reason to share one's tunics with him. Then one would just be encouraging his continuing sloth. John the Baptist must have meant that one should share with those who did not have a tunic by no fault of their own—those who in the nineteenth century were called 'the deserving poor'. Moreover, his advice on giving was directed to *individuals* and did by no means amount to an argument for forcibly removing resources such as a tunic from one person to give to another. It was about private charity, not enforced redistribution.

Nevertheless, this short story provides an occasion briefly to focus on the man with no tunic. His problem is really that of poverty. It is about the lack of necessary resources such as food, clothing and shelter. It is the condition of people who go hungry, have little or no access to clean water and proper sanitation, not to mention electricity, live in shacks, often are infected by diseases such as malaria and tuberculosis, frequently suffer violence in their neighbourhoods, and cannot afford any education. There is no disagreement that this kind of poverty, or destitution, is a social evil which it would be desirable to bring down to the lowest level possible. But there are two ways of dealing with poverty as a social problem. One is to help people to *be* poor, mitigating poverty by making it more bearable, for example by direct aid to the needy. The other way is to help people to *cease being* poor, facilitating their escape from poverty by providing more opportunities for them to produce—to sew tunics.

It was, as we have seen, Adam Smith who explained most clearly how people could increase, by division of labour and free trade, the total product of their country and thus greatly reduce poverty, even if it is true that the poor will always be with us in the sense that there has to be a proportion of the population worse off than the rest.[43] In the last two or three centuries Smith's theory has been amply confirmed in Western countries: Capitalism has turned out to be the best mechanism the world has seen of turning poverty into affluence. People under liberal capitalism have had, and availed themselves of, ample opportunities to sew their own tunics. In the less developed countries of Latin America, Asia and especially Africa, poverty remains however a grave problem. Is the situation then that we in the West have two tunics and the people in the South no tunic so that we should heed John the Baptist and share with them in the form of 'development aid'? Alas, the matter is not so simple. Development aid as the transfer of resources from the treasury of an affluent Western country to the treasury of a poor Southern country has some unintended consequences, as British development expert Lord Peter Bauer points out.[44] It tends to distort the market process and remove economic incentives in the recipient countries which in turn become dependent on aid. In those countries it also tends to strengthen the ruling class, often the greatest impediment to economic progress. In the modern world we seem to have *aid without development*, for example in Tanzania and Congo, and *development without aid*, as in Hong Kong and Singapore. Some recipients of development aid are also diverting resources into fighting domestic insurgencies and pursuing military conflicts with their neighbours, Syria for example with Israel.

To put these considerations into the language of the Bible: Even if you have two tunics and the person in the South none, it is useless to give him one of your tunics if the rulers of his country immediately and repeatedly seize his new tunic for their own purposes. It also has to be investigated whether they are making it more difficult for him, by all kinds of bureaucratic obstacles, to sew his own tunic. Adam Smith and his followers would argue that a shortage of tunics would best be resolved by a profitable garment industry. The best 'dvelopment aid' would be international free trade, enabling poor nations to use their comparative advantage (which might be cheap labour or ample supplies of some raw material, for example).

Another story from the Bible is also sometimes invoked to justify enforced redistribution. A lawyer was testing Jesus by asking him a lot of questions. When Jesus told him that he should love his neighbour as himself, he said to Jesus: "And who is my neighbour?" Jesus replied with a parable:

> A man was once on his way down from Jerusalem to Jericho and fell into the hands of bandits; they stripped him, beat him and then made off, leaving him half dead. Now a priest happened to be travelling down the same road, but when he saw the man, he passed by on the other side. In the same way a Levite who came to the place saw him, and passed by on the other side. But a Samaritan traveller who came on him was moved with compassion when he saw him. He went up to him and bandaged his wounds, pouring oil and wine on them. He then lifted him onto his own mount and took him to an inn and looked after him. Next day, he took out two denarii and handed them to the innkeeper and said, 'Look after him, and on my way back I will make good any extra expense you have.'[45]

Then Jesus asked the lawyer: "Which of these three, do you think, proved himself a neighbour to the man who fell into the bandits' hands?" He replied: "The one who showed pity towards him." Jesus said to him: "Go, and do the same yourself."

38 Karl R. Popper, *The Open Society and Its Enemies* [1945] (Milton Park, Abingdon: Routledge, 2002), p. 240.

39 Matthew, 22: 21.

40 Samuel P. Huntington, *The Clash of Civilizations and the Remaking of World Order* [1996] (New York: Simon & Schuster, 2011).

41 Matthew, 12: 8; Luke, 6: 5.

42 Luke, 3: 8–11.

43 Cf. John, 12:8.

44 Peter Bauer, *Reality and Rhetoric; Studies in the Economics of Development* (Cambridge MA: Harvard University Press, 1984).

45 Luke, 10:30–35.

The Good Samaritan by Rembrandt. He had money, and he did good with his own money.

There is a lot to be learned from this parable. First, it has often been noted that Jesus chose its hero from a community that was rather unpopular amongs the Jews, the Samaritans. This he did to stress that our neighbours are not only those with whom we are familar and comfortable, but also complete strangers: Black or white, male or female, rich or poor, all are human, and belong to what the Romans called 'universitas hominum'. An important difference between Christianity and Judaism is the universalism of Christianity, whereas Jews consider themselves to be 'the chosen people'. Thus, from a Christian point of view, if the pity we take is only on those we know, then it would hardly be as praiseworthy as the pity that the Good Samaritan took on the traveller from Jerusalem. But when speaking about unpopular communities it should be recalled that one strong argument for the free market is that it tends to be colour-blind: People are usually not interested in the colour of the baker's skin, but rather in the quality of his bread. As mentioned in Chapter 3, friendless individuals and despised minorities have an easier task selling their services in the anonymous marketplace than in convincing government officials to hire them, or not to discriminate against them. In the marketplace, the cost of discrimination is shared by the perpetrator and the victim, whereas in government institutions it is borne almost solely by the victim.[46]

In the second place, the Parable of the Good Samaritan vividly illustrates that in life there are dangers ahead because there are bandits around. While most people are honest, decent and peaceful, there are exceptions: bigots, crooks, villains, rascals, robbers, brigands, thieves, zealots, rapists, murderers. In theory at least, the state emerges mainly to protect us from aggression and violence, both from abroad and with our own society. People are, as John Locke put it, driven from a state of nature into civil society by "necessity, convenience, and inclination".[47] According to Locke, they give their consent to setting up a known authority, to which everybody may appeal upon any injury received or controversy that may arise, and they all have to obey this authority.[48] It has been argued that Locke is inconsistent in his account of how people move from the state of nature to civil society: On the one hand he describes them as relatively rational and enlightened in the state of nature; on the other hand he holds that ultimately the state of nature becomes intolerable so that they have to establish civil society.[49] But this is a paradox which readily can be resolved. We are by no means inconsistent if we hold at the same time two different theories about human nature: that man is a moral being so that he can be trusted, and that he is immoral so that he cannot be trusted. The resolution of the paradox lies in our inevitable ignorance: We do know that some people are not to be trusted, but we do not know which ones, so we have in a sense to distrust everybody. Consider a man who wants to build a new roof on his house. To do this, he chooses the carpenter whom he trusts the most. At the same time, he draws up a contract with the carpenter he chose with stipulations about the price and the time of completion and makes him sign it. He would not do this if he unreservedly trusted the carpenter: a mother and a child are not in a contractual relationship. Another example is how we design a ship: We do not build it for fair weather alone, but also for rough seas. It has to withstand gales.

This important insight into the human condition leads to the idea that political power, the power to coerce other people, has to be constrained and circumscribed. Evil men can be found in the corridors of power no less than on the road between Jerusalem and Jericho. Bigots, crooks, rascals and zealots might get into government and become not only a nuisance, but also a plain danger. The state might become a predator rather than a protector. Therefore, political institutions have to be designed and developed in such a way that bad rulers can do least harm. This applies no less to democracies than other kinds of government. We may believe that most politicians elected to high office are honourable, but the mere possibility of some of them being less than decent suffices as an argument for constitutional constraints. David Hume put this point succinctly:

> Political writers have established it as a maxim, that, in contriving any system of government, and fixing the several checks and controls of the constitution, every man ought to be supposed a *knave*, and to have no other end, in all his actions, than private interest. By this interest we must govern him, and, by means of it, make him, notwithstanding his insatiable avarice and ambition, cooperate to public good. Without this, say they, we shall in vain boast of the advantages of any constitution, and shall find, in the end, that we have no security for our liberties or possessions, except the good-will of our rulers; that is, we shall have no security at all. It is, therefore, a just *political* maxim, *that every man must be supposed a knave*; though, at the same time, it appears somewhat strange, that a maxim should be true in *politics* which is false in *fact*.[50]

In the same way, democracy should not be conceived of primarily as majority rule, or the pursuit by the general will of the common good,[51] but rather as the possibility of changing our rulers regularly without bloodshed, thus establishing some checks on them.[52] In this case it is more prudent to prepare for the worst than to hope for the best.

Hume however rejected Locke's idea of a social contract, correctly pointing out that the bulk of people have not in any intelligible way given their consent to government.[53] To establish their obligation to obey government and pay taxes it is not sufficient to prove that they tacitly have accepted the benefits of social cooperation. But Edmund Burke eloquently extended the notion of a social contract:

> Society is indeed a contract. Subordinate contracts for objects of mere occasional interest may be dissolved at pleasure—but the state ought not to be considered as nothing better than a partnership agreement in a trade of pepper and coffee, calico or tobacco, or some other such low concern, to be taken up for a little temporary interest, and to be dissolved by the fancy of the parties. It is to be looked on with other reverence; because it is not a partnership in things subservient only to the gross animal existence of a temporary and perishable nature. It is a partnership in all science; a partnership in all art; a partnership in every virtue, and in all perfection. As the ends of such a partnership cannot be obtained in many generations, it becomes a partnership not only between those who are living, but between those who are living, those who are dead, and those who are to be born. Each contract of each particular state is but a clause in the great primæval contract of eternal society, linking the lower with the higher natures, connecting the visible and invisible world, according to a fixed compact sanctioned by the inviolable oath which holds all physical and all moral natures, each in their appointed place.[54]

46 Friedman, *Capitalism,* Ch. VII. Gary Becker, *The Economics of Discrimination* (Chicago: University of Chicago Press, 1957).

47 Locke, *Second Treatise,* Ch. VII, §77.

48 Ibid., §90.

49 C. B. MacPherson, *The Political Theory of Possessive Individualism: Hobbes to Locke* (Oxford: Oxford University Press, 1962), pp. 240–241.

50 David Hume, Of the Independency of Parliament [1742], repr. in *Essays: Moral, Political and Literary* (Indianapolis IN: Liberty Fund, 1994), pp. 42–46.

51 This is Jean-Jacques Rousseau's implausible conception of democracy, *Du contrat social; ou, Principes du droit politique* (Amsterdam: Marc Michel Rey, 1762).

52 Popper, *Open Society,* p. 368.

53 Hume, Of the Original Contract [1748], *Essays,* pp. 465–487.

54 Edmund Burke, *Reflections on the Revolution in France* [1790] (Harmondsworth, Middlesex: Penguin, 1969), p. 194.

Margaret Thatcher on a tank in 1986. The state is necessary to protect us from foreign and domestic threats. Bandits are not only to be found on the road between Jerusalem and Jericho. Photo: Peter Jordan/Alamy.

In recent times, Robert Nozick has presented an ingenuous theory of political obligation, describing a process in which the state could emerge out of protective associations in the state of nature without violating the rights of those who become its citizens.[55]

I find Burke's variation on the contract theory persuasive and conclude that a liberal, democratic state, operating within constitutional constraints, under the rule of law, can be justified, with the taxation required to uphold it. But it does not follow that the state is justified in doing everything. Most goods can be produced in the marketplace, such as Robinson Crusoe's fish and Man Friday's coconuts, or the baker's daily bread, not to forget tunics for you and your neighbour. Their production and exchange should be left to individuals. There are however perhaps two pure and perfect public goods, as economists call them, of the nature that they cannot be left wholly to free enterprise: law and order on the one hand and national defence on the other hand. They both fulfil the conditions set for public goods: they are non-excludable and consumption of them by one individual does not reduce their availability to others.[56] This does not automatically mean, though, that they should be produced solely by government.[57] There are societies where law was privately enforced, such as the Icelandic Commonwealth between 930 and 1262 which produced a sophisticated legal system and some very interesting literature.[58] The ancient Icelanders had no king but the Law. Also, a lot of order and security is in fact privately produced today, such as private arbitration courts, doormen, nightwatchmen, bodyguards, locks, safes, surveillance cameras, burglar alerts, metal detectors, alarm systems, handguns and other defensive weapons. Probably in most countries more money is spent on private than public security.[59] The reason why law and order not only is a public good by definition, but also has to be ensured by government is that we cannot do without it. Life without it would in most cases be "solitary, poor, nasty, brutish, and short".[60]

National defence is also clearly a public good. We cannot do without it: the reason why the Icelandic Commonwealth survived without a government for three hundred years was that Iceland was so distant as to be practically out of reach. Even if nowadays there is little or no likelihood of Sweden going to war with Denmark or the Netherlands attacking Belgium, recent history shows the need for national defence. By the notorious 1939 Non-Aggression Pact, Hitler and Stalin between them divided up Central and Eastern Europe. Finland went to Stalin, and he attacked her in late 1939, intending to annex her, as the formation of a puppet government of Finnish communists in Terijoki showed. But the Finns put up such a brave fight that Stalin decided that it was too costly to annex the whole country, seizing instead large border areas. The Baltic countries also went to Stalin, and he annexed each of them in 1940.[61] Nominally Soviet republics, they were occupied until 1991. If the three countries had organised a united defence force, refused like the Finns to meet Stalin's initial demands and fought as ferociously as the Finns, then possibly they might have averted this tragic fate: In 1939, Finland had 3.7 million inhabitants, and the three Baltic countries together 5.7 million. The world still has not reached the goal that relations between national states would be like the relations between the five Nordic countries, or between California and Nevada in the US, or between the Canadian provinces.

I shall in Chapter 4 discuss a third possible public good, an assurance to all citizens that if they, through no fault of theirs, fall upon hard times so they cannot properly look after themselves, the state will step in and help them. But here we have shown that the Parable of the Good Samaritan is relevant to both the rise of the state and the necessity to restrain it. Moreover, two lessons about charity can be learned from the Parable. When discussing charity, people tend to focus on the *receiver,* not the *giver,* even if the act is always that of the giver and it is him or her that we applaud. Charity, like generosity and courage, is a virtue that we find praiseworthy in a person, but one on which we cannot insist, unlike honesty: a man has to keep his word, but he normally is not expected to risk his life for others. A thrifty person is not breaking any moral rule, but a generous person is surpassing them, so to speak: his virtue is one 'in excess'. In order to be charitable, generous and courageous, one has to have qualities and resources that perhaps not all have. The Good Samaritan in Jesus' parable was a man of means. He was not in a desperate hurry. He had bandages, oil and wine at his disposal and was riding a donkey which he either owned or had rented. He also had good credit, paying the innkeeper two denarii for looking after the bandits' victim, and promising to add more money if necessary. A denarius in the Roman Empire at the time of Jesus apparently was what an agricultural worker usually was paid for one day's labour.[62] So, the Good Samaritan spent at least 300 dollars in modern currency on the victim on whom he took pity. Even in an affluent country, this would be a non-negligible sum of money, but it would be quite a lot in a poor country in Northern Africa, not to mention Judea more than two thousand years ago. As Prime Minister Margaret Thatcher once remarked: "No one would remember the Good Samaritan if he'd only had good intentions; he had money too."[63]

The second lesson about charity which can be gleaned from the Parable of the Good Samaritan is that it has to be voluntary. Otherwise it is not a virtue. Compassion cannot be compelled. On the other hand, there is no such thing as public or enforced charity. This means that the help to the victim had to come out of the Samaritan's own pocket, and not through compulsory redistribution by the state. This was the reason he was the Good Samaritan. As I mentioned in the Introduction, the eleventh commandment should really be: 'Thou shalt not do good with other people's money.' But then another question becomes relevant: What is the likely outcome if poverty relief is left to government? It is clear that the total amount of money used in modern welfare societies for redistributive purposes would be sufficient to ensure a decent living standard for the poor. These are affluent societies, and the poor are not very many. But the

55 Nozick, *Anarchy,* Pt. 1, pp. 3–146.

56 James M. Buchanan, *The Demand and Supply of Public Goods* (Chicago: Rand McNally & Company, 1968). Repr. as Vol. 5 in *The Collected Works of James M. Buchanan* (Indianapolis IN: Liberty Fund, 1999).

57 For a surprising example, Ronald H. Coase, The Lighthouse in Economics, *Journal of Law and Economics,* Vol. 17, No. 2 (1974), pp. 357–376.

58 Sigurdur Nordal, *Icelandic Culture* [1942] (Ithaca NY: Cornell University Library, 1990).

59 Claire Provost, The industry of inequality: why the world is obsessed with private security, *The Guardian* 12 May 2017.

60 Thomas Hobbes, *Leviathan* [1651] (Cambridge: Cambridge University Press, 1996), Ch. XIII, p. 89.

61 Ants Oras, *Baltic Eclipse* (London: Gollancz, 1948).

62 Matthew, 20:2.

63 Interview by Brian Walden, London Weekend Television, 6 January 1980. https://www.margaretthatcher.org/document/104210

trouble is that not all the money being redistributed reaches the poor. A lot of it goes into subsidising typical middle-class activities such as going to the opera or studying French. The reason is obvious: When people are taxed, the money first goes into the treasury. When decisions are then made by politicians and bureaucrats about how to distribute it, the poor will not necessarily be strongly represented at the bargaining table.

This can be illustrated by an example. Assume that the rich are 10 per cent of the voting population and the poor another 10 per cent. This implies a middle class of 80 per cent. For a redistributive measure to be accepted, it has to gain support from representatives of at least 51 per cent of the voters. If the poor want a transfer from the rich, then they for example have to convince the representatives of at least 41 per cent of the middle class to vote with them. This they will hardly manage to do unless they can offer this group of voters something in return. As the middle class unsurprisingly is situated at the middle at any bargaining table, being able to do political deals alternatively with the poor and the rich, its representatives will normally stand to gain from such deals. According to Director's Law, named after Chicago economist Aaron Director, political redistribution favours those with most influence over political decision-makers.[64]

The poor often needlessly seem to lose in political bargains. Consider three voters, Rich, Middle and Poor. Rich earns 20,000 dollars a month, Middle 10,000 and Poor 2,000. Assume that what is available for redistribution each month is 2,000 dollars. One likely outcome would be that Middle and Poor would enter in an alliance to tax Rich and then divide the spoils up between themselves so that each of them gets 1,000 dollars. But another possible alliance would be between Poor and Rich about lowering the redistributive tax by 500 dollars and let the entire booty of 1,500 dollars go to Poor. Both Rich and Poor would gain from it. Middle would 'lose' (if that is the right word), but he did not need the transfer anyway. American economist Gordon Tullock surmises that the reason why such deals between rich and poor, bypassing the middle class, seem to be rare might be that the poor are often less energetic in pursuing their goals and less well informed than other social groups, not least the educated and articulate middle class. There is another intriguing possibility, on these assumptions: If the redistributive tax was abolished, then Rich would have 2,000 more dollars at his disposal, and it is not unlikely that he would give at least half of it to charity. Thus, paradoxically, the poor might be as well or even better off by relying mainly on private charity.[65]

I have made four points about the Parable of the Good Samaritan: Its protagonist was from a despised minority; we have to have protection against bandits; the Good Samaritan was a man of means; and he helped the bandits' victim with his own money, not that of other people. A fifth point is worth noting. It is that the people who went to the other side of the road were the priest and the Levite. It could be said in their defence that they might have been afraid that this was an ambush, and also that possibly they were afraid of touching the man lest he be dead in which case they would have become unclean.[66] But this is irrelevant because Jesus was contrasting, and not excusing, the behaviour of those two to that of the Good Samaritan. The priest would have been from the Temple in Jerusalem, and the Levite was from a Jewish tribe that performed particular religious duties among the Israelites. Both were intellectuals who could be expected to know their duties and the law better than an ordinary layman: If the man was alive, they should have helped him; if he was dead, they should have helped to bury him. In order to avoid the inconvenience, they both went to the other side of the road. They, like so many intellectuals, did not practise what they preached. Unlike the Good Samaritan, they did not, to use a vigorous American phrase, put their money where their mouth was. They were like Mrs. Jellyby in Dickens' *Bleak House*: A 'telescopic philanthropist', she was busy with far-fetched and ultimately unsuccessful reform schemes in Africa, and neglected her own family. In the following chapters we will discuss some of the theories which unkind commentators might say intellectuals were offering as to why the Samaritan should be taxed so that the priest and the Levite could redistribute his money to those whom they would regard as being fit to receive it.

64 George Stigler, Director's Law of Public Income Redistribution, *Journal of Law and Economics,* Vol. 13, No. 1 (1970), pp. 1–10.

65 Gordon Tullock, The Charity of the Uncharitable, *Western Economic Journal,* Vol. 9, No. 4 (1971), pp. 379–92.

66 Cf. Leviticus 21:1–3.

4

THE PHILOSOPHICAL AND POLITICAL FOUNDATIONS OF THE WELFARE STATE

In early nineteenth century, poverty gained a new meaning: it became relative as well as absolute, a counterpart of wealth rather than the lack of means. No longer was the main problem seen as being that you had two tunics and your neighbour none; it was rather that you had three tunics and your neighbour only one. This problem required a comprehensive solution by the state, it was thought, instead of the traditional and limited relief measures undertaken by local communities. While it was German Chancellor Otto von Bismarck who late in the century introduced the welfare state in his country, its philosophical foundations were laid by the philosopher Georg W. F. Hegel, Professor at Berlin University,[67] in his *Grundlinien der Philosophie des Rechts*, published in 1821.[68]

In Hegel's social and political theory poverty was a central concept. He discussed at length the civil society that John Locke and Adam Smith had described, and found it wanting. Hegel taught that if a society was to be legitimate, it had to have 'universality'; in other words a sense of citizenship, of people identifying with the state, of feeling at home there. But in civil society as such what existed was only 'particularity'. The relationship of one man with other people was based on self-interest, on the mutual fulfilling of needs, not on any common identity. Civil society was a society of strangers. Thus, a sense of loss, or alienation, was created; some members of the community did not identify as its members, they experienced the community as something external and unintelligible. There was a conflict between what Smith had called the 'commercial spirit' and the demands of the community in which man could fulfil his role as man. It was a conflict between civil society and the state which could only be overcome by the *Aufhebung* of civil society into the state, or in other words the simultaneous inclusion of civil society in the state and its abolition (as an independent or autonomous social entity) by the state. This meant, if translated into more modern terms, a welfare state, correcting the outcomes of the 'blind' play of the market forces.

Portrait of G. W. F. Hegel by Jakob Schlesinger. Hegel worried about how to integrate the poor into modern society.

67 While it was founded in 2009 as Berliner Universität, it was called Friedrich-Wilhelms-Universität in 1828–1945, and Humboldt-Universität zu Berlin since then.

68 G. W. F. Hegel, *Die Grundlinien der Philosophie des Rechts* (Berlin: Nicolaischen Buchhandlung, 1821). *Hegel's Philosophy of Right*, trans. by T. M. Knox (Oxford: Clarendon Press, 1942).

Hegel thought that unfettered capitalism had two basic flaws. First, the division of labour, although on the whole beneficial, had some undesirable social consequences; the individual was enervated; he was deprived of the intellectual development which was only possible within a community.[69] Secondly, the individual became the prey of blind and uncontrolled market forces with all their unpredictability and uncertainty. Overproduction forced people into poverty, turning them into "a rabble of paupers",[70] and creating alienation in the process. At the same time, other people gained economic power. Hegel was well aware that poverty had existed before capitalism, and he was familiar with the argument of Adam Smith and the other classical economists that capitalism created wealth, not poverty. But he held that in the context of capitalist society the existence of poverty was a social problem, whereas in pre-capitalist society it might have been an individual one. The poor in a progressive society were left behind, while others prospered; they became a class of their own, perceiving themselves as outcasts. By their membership in a progressive society they had come to form certain expectations, which were legitimate, but unfulfilled.

In practical politics, what this amounts to is an idea of poverty as relative deprivation which has to be relieved by the state, and the notion that socially generated expectations are legitimate and that the state has, likewise, to step in and to fulfil them. The liberal state—the state as confined to civil society—is not enough. It is, in the Hegelian scheme, almost a contradiction in terms. Underlying the argument, there is a conception of man as a being who gains his identity from and within a community and whose wants and needs are socially developed. Man can only capture his essence or find himself in the state, by which Hegel meant the ethical community, the community of shared ideals and ends. Man is free only in so far as he is a member of such a community, participating in its *Sittlichkeit*. As a citizen of the state, he has duties towards his fellow-citizens. But he has also rights against them which transcend the contractual rights of civil society. Hence the welfare state with its conception of social justice is rational, indeed inescapable.

Barge haulers on Volga by Ilya Repin. In Russia, poverty became the disintegrating force Hegel feared.

In his critique of civil society, Hegel faced a dilemma, however. It was that he wanted at the same time to retain and reform it. On the one hand, the 'particularity' of civil society implied freedom, variety and individuality; on the other it implied the alienation of those who were deprived by civil society of the fulfilment of needs which history or civil society had generated. The way out of this dilemma appeared to Hegel to be through a welfare state, where the market forces are allowed to operate, but where government 'corrects' or mitigates their operation by intervention. He wrote:

> When the masses begin to decline into poverty, the burden of maintaining them at their ordinary standard of living might be directly laid on the wealthier classes, or they might receive the means of livelihood directly from other public sources of wealth (e. g. from the endowments of rich hospitals, monasteries, and other foundations).[71]

Hegel was however well aware that such a welfare state might create as well as solve problems. It might be true that civil society caused the alienation of those who were less than successful in the marketplace and therefore felt excluded. But whether their problems were met by private charity or government poverty relief, it could also cause the alienation of its beneficiaries. A welfare recipient did not have the sense of dignity and responsibility enjoyed by a citizen. Hegel remarked: "In either case, however, the needy would receive subsistence directly, not by means of their work, and this would violate the principle of civil society and the feeling of individual independence and self-respect in its individual members."

Hegel's other solution, Keynesian before Keynes, was the creation of jobs through public works: "As an alternative, they might be given subsistence indirectly through being given work." But there was a problem about that, Hegel noted:

> In this event the volume of production would be increased, but the evil consists precisely in an excess of production and in the lack of a proportionate number of consumers who are themselves also producers, and thus it is simply intensified.[72]

Civil society could not ensure the consumption of its production since it tended, according to Hegel, to over-production. Hegel concluded:

> This inner dialectic of civil society thus drives it—or at any rate drives a specific civil society—to push beyond its own limits and seek markets, and so its necessary means of subsistence, in other lands which are either deficient in the goods it has overproduced, or else generally backward in industry, etc.[73]

69 Hegel, *Grundlinien*, §243.

70 Ibid., §244.

71 Hegel, *Grundlinien*, §245.

72 Op. cit.

73 Ibid., §246.

But such kind of 'imperialism' was only, of course, a temporary solution. One day the whole world would find itself in the same situation.

To some extent, Hegel may have realised that his solution was not necessarily better than the problem which it was supposed to solve. The welfare state with its security and dependency was not necessarily better than civil society with its insecurity and individuality. Moreover, the problem may not be as serious as Hegel thought. Consider over-production and its Keynesian counterpart, under-consumption. Hegel's belief that markets do not clear, equating supply and demand, is implausible.[74] The concept of a price is curiously absent from his analysis. The question in the marketplace is not whether to take a good or to leave it, but what price is exacted for it. If people are willing to charge a lower price for their goods, they can sell them. In other words, there is no such thing as over-production in the long term. There is only production at a price which other people are not willing to pay. There is also, of course, occasional dis-coordination in the economy which is ascribed to a lack of information about available opportunities: Even if the price of a good is lowered, potential buyers may not be aware of it. The task of the state, then, should be, on Hegel's own premise, to try and eliminate rigidities in the labour market and other markets and the distortion of information, and this it can only do, most economists would agree, by allowing the market forces freely to operate.

Moreover, money spent by government on public works would alternatively be spent by profit-seeking individuals. Both economic theory and the empirical evidence tell us that such profit-seeking individuals are more likely to find opportunities for growth and hence for the creation of jobs than government officials. This is not primarily because they have a greater incentive, although that is certainly true, but because they operate under a more efficient feed-back and 'filter' system where mistakes are costly and eventually lead to the elimination through bankruptcy of those who make them. Milton Friedman liked to tell the story of when he was shown the construction of a massive new canal in Asia. As he found it strange that the workers were moving huge amounts of earth and rock with small shovels, rather than with bulldozers, trucks and other machines, he was told: "But this is a job programme." He responded: "Oh, I thought this was about building a canal. If you are seeking to create jobs, why didn't you give them spoons rather than shovels?"[75]

Thirdly, while a permanent rabble of paupers may be created by extensive poverty relief, as Hegel feared, those who are rejected by the market are only rejected so long as they try to exact a price for their services which is deemed unreasonable by the rest of society. As soon as they lower their price, or improve their services, they are accepted again by the market. On balance, it can be argued that a consistent Hegelian would, indeed should, prefer bankruptcies of a few businessmen, and the temporary hardship of those hit by market forces, to permanent pockets of poverty as in the slums in Bronx and in some of the Merseyside communities where individuals may lose all sense of responsibility and do nothing but collect their weekly cheques from government.[76] The market is an adjustment process. It allows those who make mistakes to correct them. Hence, it gradually eliminates the alienation and social exclusion about which Hegel was worried.

I conclude that the problem of relative deprivation in the marketplace is not as serious as Hegel thought, although a few poor people will always be with us, such as the permanently handicapped. The relative deprivation which undoubtedly exists in civil society is not always the result of market forces: it can sometimes be attributed to political forces or to individual unwillingness to adjust to change. When I was at Oxford, one of my teachers was legal theorist Ronald Dworkin. In one of his lectures he criticised Prime Minister Margaret Thatcher for abandoning the full employment policies of her predecessors. Unemployment was creating social unrest, he said. I raised my hand and objected: "But surely unemployment can be reduced by market forces." Dworkin smiled, perhaps a bit overbearingly, and responded: "Yes, but it would take so long." Would it really? Two legal measures would for example reduce unemployment fairly quickly: One would be to abolish minimum wage laws so that young and unskilled workers could price themselves into jobs. Another measure would be to set unemployment benefits at a low, albeit adequate level; this would remove the temptation to go on benefits instead of looking for jobs; certainly such benefits should at least not be relative to previous income. Moreover, the cost of relocating from a low to a high employment area is often raised by government policies. But most importantly, the labour market has to have flexible prices, like other markets.[77]

However, Hegel may have offered a cogent argument from integration for regarding poverty relief as a real public good whose production the state has to ensure. For our own sake, we do not want society to disintegrate with a considerable part of the population turning into a discontented rabble. Prevention is a prudent policy. Also for our own sake, we want to make sure that if we are unlucky ourselves, for example if we end up in a wheelchair after an accident or get a chronic disease whose treatment is costly, then we will nevertheless enjoy the decent living standard to which we have become accostumed. Private insurance may of course to a large extent meet this need, but we want to be sure that we do not fall below a certain safety net whose extent would of course be conditional. Therefore it can be said when we are taxed to pay for the production of the three widely accepted public goods, poverty relief in addition to national defence and public security, that we can expect to get what we have paid for. This does not necessarily mean that a positive right of the poor to other people's money has been accepted: they do not have just claim to it. It means, rather, that society as a whole realises that it has to maintain itself, defending itself against external and internal aggression and disintegrating forces such as relative deprivation. It has, in Hegel's terminology, to ensure the 'universality' of the state in addition to the 'particularity' of civil society.

While Hegel identified the problem of poverty as relative deprivation, we have seen that he was ambivalent about its possible solutions although he mentioned direct transfers and public works. This has led one of his commentators to say that poverty was the only problem Hegel identified, but left without trying to solve it.[78] Not all prominent German scholars of the nineteenth century were however as subtle as Hegel. Reactionaries and radicals alike roundly condemned economic liberalism. '' 'Manchesterism' (*Manchestertum*) as support for a free economy was a word of abuse, invented by socialist leader Ferdinand Lassalle, who also coined the term 'Nightwatchman State' (*Nachtwächterstaat*) for a liberal, non-interventionist state. In German universities a critique of civil society similar to that offered by Hegel found many followers, not least among the 'Socialists of the Chair' (*Kathedersozialisten*), university professors hostile to the free market order, such as Gustav von Schmoller, Adolph Wagner and Werner Sombart. They were not necessarily Hegelians, and some of them disagreed sharply with Hegel on many issues, but they shared his concerns about the workings of unbridled capitalism. The Socialists of the Chair were ardent nationalists, even militarists, who held that the state should be aggressive and vigorous, using compulsion and coercion at will, instead of being primarily the setting or venue for mutual recognition and reconciliation of individuals as Hegel had envisaged.[79]

In January 1871 Germany was unified under Bismarck's leadership and his loyal Prussian King, William I, who became German Emperor. In the next two decades Bismarck as Chancellor tried to consolidate the new state and weaken alternative sources of allegiance. First, he turned against the Catholic Church, dissolving the Jesuit Order, severing diplomatic relations with the Vatican, placing religious teaching under government control, making civil marriage obligatory and even imprisoning some bishops. His campaign against the Catholic Church was vigorously opposed by the Centre Party, and eventually Bismarck and the Catholics reached a compromise. Then, Bismarck moved against the socialists. The Socialist Workers' Party of Germany, SPD, had been founded as a Marxist party in 1875 and gained 9 per cent of the votes in the 1877 Reichstag elections. In 1878, Bismarck used failed assassination attempts on the Emperor to pass laws that severely restricted the activities of the SPD, even if its members continued to sit in the Reichstag.

74 Henry Hazlitt et al., *The Critics of Keynesian Economics* (Princeton NJ: Van Nostrand, 1960); W. H. Hutt, *The Theory of Idle Resources* (Indianapolis IN: Liberty Press, 1975).

75 Cf. Tom G. Palmer, *Realizing Freedom* (Washington DC: Cato Institute, 2009), p. 267.

76 Hermione Parker, *The Moral Hazard of Social Benefits* (London: Institute of Economic Affairs, 1982); Martin Anderson, *Welfare* (Stanford CA: Hoover Institution, 1978).

77 Patrick Minford et al., *Unemployment: Cause and Cure* (Oxford: Martin Robertson, 1983).

78 Shlomo Avineri, *Hegel's Theory of the Modern State* (Cambridge: Cambridge University Press, 1972), p. 154.

79 Contrary to received wisdom, Hegel was not a German chauvinist. Shlomo Avineri, Hegel and Nationalism, *The Review of Politics,* Vol. 24 No. 4 (1962), pp. 461–484.

Portrait of Otto von Bismarck by Franz von Lenbach. Bismarck introduced the German welfare state in an attempt to shift votes from socialists.

The anti-socialist laws were in force for the next twelve years. But Bismarck thought those laws were not sufficient to curb this new political force which had gained the support of many urban workers. So, he decided to try and deprive the SPD of support by introducing benefits for workers that went far beyond traditional provisions for the poor. While his move was thus strategic rather than ideological, Hegel and the Socialists of the Chair had prepared the ground in which Bismarck now sowed and reaped bountifully. German liberalism, always weaker and more timid than its British counterpart, had lost support, not least as a result of an economic crisis in the 1870s, and in 1878 Bismarck had broken off his informal alliance with the National Liberal Party and abandoned free trade.[80]

The first step towards a modern welfare state was taken in a letter from the German Emperor to the Reichstag in 1881 where he wrote that "those who are disabled from work by age and invalidity have a well-grounded claim to care from the state".[81] A year later Bismarck commented in the Reichstag: "Many of the measures we have taken are socialist, and as it is, the state in our Reich will have to get used to a little more Socialism."[82] In 1883, health insurance for German workers was established, jointly financed by employers and employees and administered by local sickness funds. Accident insurance was established in 1884, financed and administered by employers. Old age and disability insurance was established in 1889, financed by a tax on employees and designed to provide pensions for them when they reached the age of 70.

Even if Bismarck was implementing many planks in their platform, the German Social Democrats fought against his proposals. In the *Communist Manifesto* Marx and Engels had contemptuously dismissed what they called 'conservative socialism':

> A part of the bourgeoisie is desirous of redressing social grievances, in order to secure the continued existence of bourgeois society. To this section belong economists, philanthropists, humanitarians, improvers of the condition of the working classes, organizers of charity, members of societies for the prevention of cruelty to animals, temperance fanatics, hole-and-corner reformers of every imaginable kind.[83]

The German Social Democrats explicitly rejected Bismarck's State Socialism: "Social Democracy is by its nature revolutionary. State Socialism is conservative. Social Democracy and State Socialism are irreconcilable opposites."[84]

Shortly after Bismarck left office in 1890, a workers' protection act was passed in Germany, designed to increase workplace safety, banning work on Sunday and introducing a maximum working day of 11 hours for women. The three pillars of social security, concerning health and accident, old age and disability, were unified into the Reich Insurance Code *(Reichsversicherungsordnung)* in 1911. Meanwhile, under the influence of the Socialists of the Chair, the German Empire had adopted protectionism. As Austrian-American economist Ludwig von Mises observed: "The much glorified Sozialpolitik was only possible within an economic body sheltered by tariffs."[85] Whereas Bismarck was not successful in halting the advance of the German Social Democrats, in the twentieth century his welfare reforms were adopted by governments all around the world. When Welsh politician Lloyd George became British Chancellor of the Exchequer in 1908, he visited Germany to study her insurance system.[86] In the next few years, George introduced some similar welfare measures in the United Kingdom such as the 1911 National Insurance Act, making provisions for the sick, the invalid, and the unemployed. These measures were to be financed mainly by a progressive income tax, and a 20 per cent tax on the unearned increase in value of land. "Who ordained that a few should have the land of Britain as a perquisite, who made 10,000 people owners of the soil and the rest of us trespassers in the land of our birth?" George asked.[87] The only thing this great orator was not prepared to do for the poor was to become one of them.[88] Even some self-proclaimed liberals now accepted that taxation should aim at redistribution and not only at financing basic government services. "The true function of taxation is to secure to society the element in wealth that is of social origin, or, more broadly, all that does not owe its origin to the efforts of living individuals," British journalist L. T. Hobhouse wrote in a 1916 introduction to modern liberalism.[89]

In the Great Depression of the 1930s, many thought that governments should not only make provisions for the unemployed, but also try to aim at full employment, pursuing expansionary policies during economic downturns. These policies were inspired by British economist John Maynard Keynes and, as he said himself in a Foreword to the 1936 German edition of his *General Theory of Employment, Interest and Money*, "much easier adapted to the conditions of a totalitarian state" than "under conditions of free competition and a large degree of laissez-faire".[90] The same year as Keynes wrote these words for his German audience, Lloyd George visited Germany and was much impressed by the expansion of the Nazi welfare state, applauding the "marvellous transformation in the spirit of the people", with Hitler "securing them against that constant dread of starvation which is one of the most poignant memories of the last years of the war and the first years of the Peace."[91] In 1942, British economist William Beveridge, a member of the Liberal Party, published an influential report on comprehensive social insurance, and the British Labour government in

Ludwig von Mises pointed out that the protection of relative positions within a society might require limits on international free trade. Photo: Mises Institute.

80 Ralph Raico, *Die Partei der Freiheit. Studien zur Geschichte des deutschen Liberalismus* (Stuttgart: Lucius & Lucius, 1999).

81 17 November 1881, here after Michael Stolleis, *Origins of the German Welfare State: Social Policy in Germany to 1945* (Berlin: Springer, 2013), p. 57.

82 Speech in the Reichstag 12 June 1881, here after Stolleis, *Origins*, p. 62.

83 Karl Marx and Friedrich Engels, *Manifest der Kommunistischen Partei* [1848], Ch. III, Section 2, *Werke,* Vol. 4 (Berlin: Dietz, 1977), p. 488.

84 Resolution in 1892, here after Stolleis, *Origins*, p. 64.

85 Ludwig von Mises, *Omnipotent Government: The Rise of the Total State and Total War* [1944] (Indianapolis IN: Liberty Fund, 1988), p. 88.

86 Kenneth O. Morgan, Lloyd George and Germany, *The Historical Journal,* Vol. 39, No. 3 (1996), pp. 755–766.

87 Speech in Newcastle 9 October 1909, *The Times* 11 October 1909.

88 Jennie Lee, *My Life with Nye* (London: Cape, 1980), p. 44.

89 L. T. Hobhouse, *Liberalism* (London: Williams & Norgate, 1916), p. 202.

90 John Maynard Keynes, *The General Theory of Employment, Interest and Money* [1936], *The Collected Writings of John Maynard Keynes,* Vol. VII (London: Macmillan, 1973). *Allgemeine Theorie der Beschäftigung, des Zinses und des Geldes* (Berlin 1936: Duncker & Humblot).

91 Quoted in *Daily Express* 17 November 1936.

1945–1951 implemented many of his proposals. In the United States, President Franklin D. Roosevelt and his successors also adopted many welfare measures.

In the four decades following the Second World War, the welfare state continued to expand in most countries. In late twentieth century it became common to distinguish between three models of welfare capitalism.[92] The Bismarckian model is followed in some countries on the European continent, notably Germany and Austria. It is shaped by family values, with the state stepping in when family resources are exhausted. The Anglo-Saxon model, observed in the United States, United Kingdom, Australia, Canada and New Zealand, is based on modest, means-tested assistance and mainly targeted at low-income groups. It typically provides direct subsidies to the needy rather than subsidised social services to all. The emphasis is on entrepreneurship and economic growth rather than on reducing inequality. The Nordic model, implemented in the three Scandinavian countries, focuses on ensuring general rights to decent living standards and not only on satisfying minimal needs. It provides extensive social services such as subsidised child care and old people's homes. The economy is open and relatively free, whereas taxes are high, and there is not much inequality of wealth or income.

While this typology may sometimes be useful, all welfare states seem to have three features in common. First, instead of developing further the extensive, but informal social security networks existing before and provided by organisations such as the family, local communities, friendly societies and the Church, they tore those networks apart and replaced them by a compulsory system of benefits and services. The emphasis moved from charity to redistribution, with no role for a Good Samaritan.[93] In the second place, the great paradox of the modern welfare state is that it has rapidly grown at the same time as the problems it was designed to solve have been greatly reduced. Poverty as destitution has largely disappeared in prosperous Western societies. People from social groups who in the past would not have been able to afford private health insurance or secondary education for their children, now are relatively affluent and could easily pay for such services, provided of course their tax burden was lowered. Redistribution is now less to the needy than to the politically powerful, as Director's Law would predict. Thirdly, as the welfare state has grown, it has become very costly and in some cases clearly unsustainable. This is most obvious in pay-as-you-go pension schemes. While the labour force is shrinking, people now live much longer, which implies that pension entitlements are exceeding the money available for pension payments. Perhaps the best example of the problems and perils of the welfare state can be seen in Sweden, and it is to this country that we shall now turn.

92 Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton NJ: Princeton University Press, 1990).

93 Cf. D. G. Green, *Reinventing Civil Society: The Rediscovery of Welfare Without Politics* (London: IEA Health and Welfare Unit, 1993).

5

THREE SWEDISH MODELS

The five Nordic countries, Sweden, Denmark, Finland, Norway and Iceland, are rightly regarded as successful societies. They are affluent, but without a wide gap between rich and poor. They provide social security, but without a significant erosion, it seems, of their freedoms. They are small, but they all enjoy an international reputation as peaceful, civilised democracies. The Nordic nations are healthy and well-educated, and the crime rate is low. Recalling Friedrich von Hayek's tract against socialism, *The Road to Serfdom,* Harvard economist Jeffrey D. Sachs asserts that the Nordic countries refute him. "In strong and vibrant democracies, a generous welfare state is not a road to serfdom but rather to fairness, economic equality and international competitiveness."[94] I would however argue that this is a misunderstanding, not only of von Hayek—who was uttering a warning and not offering a prediction—but also and more importantly of the Nordic success story. The system of high taxes, extensive redistribution and general and generous welfare benefits without any means-testing that Scandinavian social democrats introduced in their heyday in the third quarter of the twentieth century turned out to be untenable. Moreover, there is no single Nordic model, even if there are strong resemblances between the three Scandinavian societies, Sweden, Denmark and Norway, with Finland and Iceland being different from them in various respects. Indeed, because the 'Swedish model' is frequently invoked, a distinction can be made between at least three Swedish models, the liberal one of 1850–1970, the social democratic one of 1970–1990, and the present model of a liberal, restrained welfare state.

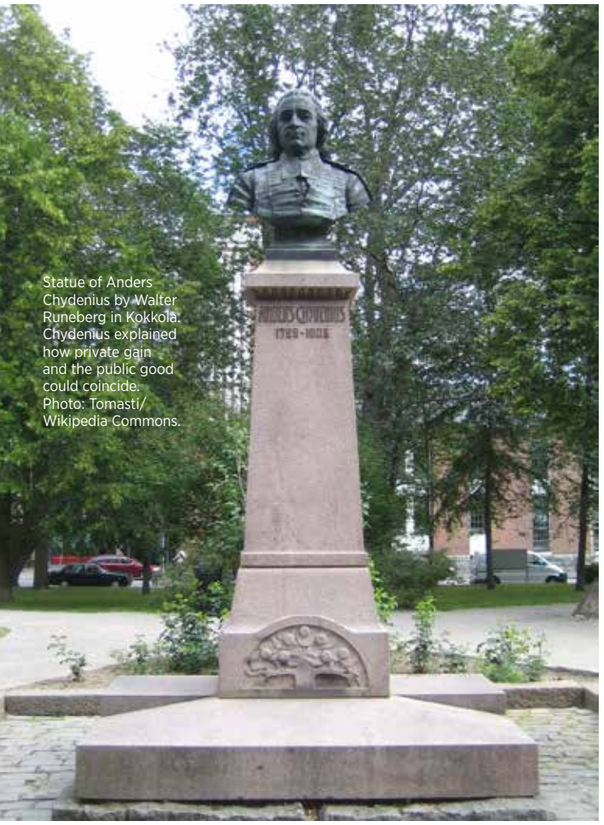
It is doubtful that social democracy captures any essence or collective identity of the Nordic nations. They, not least the Swedes, have strong liberal traditions. The ancient Swedish farmers were sturdy individualists who insisted on their rights against their kings. Icelandic chronicler Snorri Sturluson tells the story of the Swedish Law-man Thorgnyr. In early 11th century, when Swedish king Olof Whoodwhittler wanted to wage war against Norway, Thorgnyr, on behalf of the farmers, spoke against the king at an assembly, praising past kings who had unlike the present one listened to the people. "He wants to have the Norway kingdom laid under him, which no Swedish king before him ever desired, and therewith brings war and distress on many a man," Thorgnyr said. Instead, he should marry a Norwegian princess and pursue peace. The Law-man then addressed the king directly and bluntly: "But if thou wilt not do as we desire, we will now attack thee, and put thee to death; for we will no longer suffer law and peace to be disturbed."[95] The king relented. A modern namesake of the old Law-man, Swedish journalist Torgny Segerstedt, said more than nine hundred years later that individuality was deeply ingrained in the self-reliant and industrious Swedes. "When a Nordic person says 'This is not right', one has collided with a block of granite."[96]

It is little known, but highly relevant, that an eighteenth century writer in the Kingdom of Sweden, which then included Finland, anticipated many of Adam Smith's ideas. This was Anders Chydenius who as a young pastor in Nedervetil, a small town in Ostrobothnia in the central part of Finland, became interested in ways of alleviating the dire poverty he witnessed among the peasants in his parish. In 1763 he participated in an essay contest on the question: "Why do so many people leave the Kingdom of Sweden?" He argued that there was nothing wrong with emigration. If the Swedes wanted to reduce

94 Jeffrey D. Sachs, Welfare States beyond Ideology, *Scientific American*, Vol. 295, No. 5 (2006), p. 42.

95 Snorri Sturluson, *Saga of King Olaf Haraldsson the Saint, Heimskringla*, Vol. II, Ch. LXXXI (London: Longman, Brown, Green and Longmans, 1844), pp. 93–94.

96 Here after Johan Norberg, *Den svenska liberalismens historia* (Stockholm: Timbro, 1998), p. 10.



Statue of Anders Chydenius by Walter Runeberg in Kokkola. Chydenius explained how private gain and the public good could coincide. Photo: Tomasti/ Wikipedia Commons.

it, then it was necessary to reform the economy. Chydenius detailed the abuses, regulations and taxes which made it difficult to escape poverty in Sweden. "Fatherland without freedom and merit is a big word with little meaning." When Chydenius was in 1765 elected to the Swedish Diet he successfully campaigned for the abolition of trade restrictions which in his home district were particularly harmful as the towns there were compelled to trade with Stockholm alone, not with one another. Chydenius also managed to have greater freedom of the press passed into law.

In 1765, Chydenius wrote a short treatise, *The National Gain*, where he gave a succinct outline of a liberal economic theory, explaining how individuals seeking their own gain could thereby benefit others, if operating in a free, competitive market and not in a political race for power. He argued that "every individual spontaneously tries to find the place and the trade in which he can best increase National gain, if laws do not prevent him from doing so."[97] The pursuit of National gain

> relieves the Government from thousands of uneasy worries, Statutes and supervisions, when private and National gain merge into one interest, and the harmful selfishness, which always tries to cloak itself beneath the statutes, can then most surely be controlled by mutual competition.[98]

Chydenius also displayed a keen understanding of the division of labour. "If ten men produce goods to the value of 100 Daler a day in one trade, but in another to a value of not more than 80, it is obvious that in the latter eventuality the Nation will lose 20 Daler a day on those ten men's work."[99]

The Swedish-Finnish pastor was tireless in trying to limit the power of the state to tax, observing that the old commandment, 'Thou shalt not steal' applied to the state as well as to its citizens. But he proved too radical for some of the Swedish nobles and after an eventful year he was thrown out of the Diet. His influence continued however to grow and later he drafted a bill for the Swedish king on religious freedom which gave Jews the right to settle in Sweden. It was not least because of Chydenius' arguments that farmers gained more control over their land and that agricultural trade was liberalised. In 1770, Chydenius became rector, a combination of pastor and church administrator, in Gamlakarleby (Kokkola in Finnish) in Ostrobothnia, on the coast of the Gulf of Bothnia, living there to the end of his life. When Chydenius returned to the Diet, he championed the rights of farmhands and domestic servants. One of his most original ideas, presented in his old age, was to establish a free-market-zone in Lapland, the northern parts of Sweden and Finland.

The first Swede to call himself 'liberal' was army officer Count Georg Adlersperre who translated parts of Adam Smith's *Wealth of Nations* into Swedish. After king Gustav IV Adolf in 1809 had lost Finland to the Russians, Adlersperre led a successful revolt against

97 Anders Chydenius, *Den nationale vinsten* (Stockholm: Lars Salvius, 1765). *The National Gain*, §5 (London: Ernest Benn, 1939), http://www.chydenius.net/historia/teokset/e_kansallinen_johdanto.asp

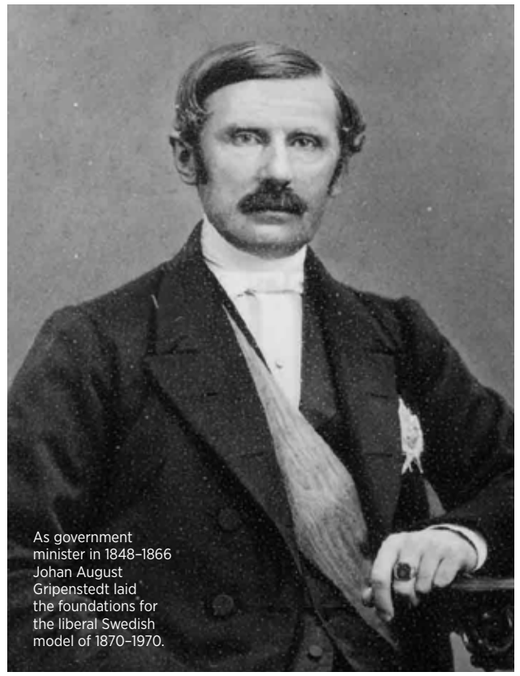
98 Ibid., §31.

99 Ibid., §8.

him. The king's old uncle became king, and restrictions on the freedom of the press were abolished. A constitution was adopted which in a perhaps typical Swedish way was the result of a compromise between liberals and conservatives. Freedom of the press, of religion and of assembly, and the protection of property rights were guaranteed, while the nobility retained some of their privileges. However, when Adlersparre's candidate to succeed the childless king suddenly died, he retired from politics. In early nineteenth century, the most prominent Swedish liberal was nobleman Lars Johan Hierta. At once a successful entrepreneur and a political activist, in 1830 he founded *Aftonbladet* which became a bastion of liberalism and the growing middle class, fighting against class privileges and economic controls. Hierta had a copy of a famous painting of the American revolutionaries of 1776 on the wall in his office, and he strongly believed that no group should be allowed to "take money out of others' pockets". His liberalism was eclectic, bringing together utilitarian arguments and ideas of natural rights. "Some would argue that this is characteristic of the Swedish mentality," Swedish historian Johan Norberg remarks.[100] Hierta and other liberals were convinced that the only way to bring Sweden out of poverty was to liberalise the economy which would create new opportunities both for the peasants remaining in the countryside and for the poor masses flocking to the cities.

In the nineteenth century, slowly but surely liberal ideas gained ground in Sweden. An ardent disciple of French liberal Frédéric Bastiat, Johan August Gripenstedt, was in 1848 appointed minister without portfolio, and in 1856 finance minister. In the following decade he used his considerable political skills to implement many liberal reforms, especially after he was in 1858 joined in the government by another committed liberal, Baron Louis De Geer. "It is no exaggeration to say that Sweden experienced a nonviolent liberal revolution between 1840 and 1865," Norberg notes. The old Diet was replaced by a bicameral Parliament; the guilds were abolished; entry into business was facilitated; regulations on the important timber and iron industries were lifted; tariffs were lowered; a law was passed on joint-stock companies; banks were established and interest rates deregulated; public education was improved; freedom of the press and of religion were expanded; women won rights to own and inherit property, receive education and make a career. In 1865, Sweden joined the free-trade treaty between France and the UK. Two years later, when the new bicameral Parliament convened for the first time, Lars Johan Hierta, as its oldest member, gave the welcoming speech, celebrating recent liberal reforms and warning his fellow parliamentarians not to devise new ways of taking money from the people.

Gripenstedt was in the habit of quoting the poet Tegnér that Sweden could within her own borders "regain Finland", meaning that she could grow inwards instead of outwards, thus compensating for territory losses. She could engage in trade rather than warfare. When Gripenstedt said that Sweden, one of the poorest European countries at the time, could become one of the richest through free trade and modernisation, his opponents tried to ridicule him and his "flower paintings".[101] But Gripenstedt was proved right. Economic liberalism transformed Sweden. In 1860–1910, real earnings of male industrial workers increased by 25 per cent a decade; life expectancy



As government minister in 1848–1866 Johan August Gripenstedt laid the foundations for the liberal Swedish model of 1870–1970.

100 Johan Norberg, How Laissez-Faire Made Sweden Rich, https://www.libertarianism.org/publications/essays/how-laissez-faire-made-sweden-rich

101 Norberg, *Den svenska liberalismens historia*, p. 147.

increased by 12 years. It is interesting that in the fifty years from 1860 to 1910, real earnings increased by 170 per cent, whereas in the next fifty years, from 1910 to 1960, they increased by 110 per cent.[102] The living standards of ordinary people improved not only as a result of higher earnings, but also because they got running water, sewerage and electric lights installed in their homes, and access to other material goods. During this period, government remained small: at the turn of the century, central public expenditure was only about 6 per cent of GDP. New companies were founded to produce goods out of the 'green gold', as timber was called, and out of iron and other resources. Entrepreneurs flourished: Lars Magnus Ericsson of LM Ericsson, Alfred Nobel of Nitroglycerin, Swen Wingquist of SKF, Gustaf Dalén of AGA, Axel Wenner-Gren of Electrolux, André Oscar Wallenberg of Stockholms Enskilda Bank, to name a few.

The new Swedish Parliament did not altogether heed Hierta's advice to serve only the common good instead of special interests. In the 1880s tariffs on grain were raised, and anti-liberal conservatives took power. In 1889, the Social Democratic Party was founded with the explicit goal of gaining power and using it for the benefit of only a segment, albeit a large one, of the population. The Social Democrats were however against 'hunger tariffs', realising that they reduced the living standards of the poor. Slowly, liberalism ceased to be a new and attractive idea and seemed to become merely a defence of the status quo. Great Britain had long been the model for many Swedes, but now Bismarck's new state south of the Baltic Sea, the vigorous German Empire, was viewed with admiration, not least Bismarck's introduction of government-funded welfare benefits and of tariffs to protect domestic industry, described in Chapter 3. During and after the First World War the old differences in Sweden between conservatives and liberals were gradually replaced by differences between on the one hand conservative-liberals in a broad sense, split into many political parties, and on the other hand socialists, organised in one large party, the Social Democrats, with a small communist party to their left.

Two renowned Swedish economists became outspoken critics of advancing socialism. Professor Gustav Cassel was a world famous monetary economist who developed the idea of purchasing power parity. He was also an excellent writer who contributed a stream, almost a torrent, of articles to Swedish newspapers in the 1920s and 1930s on the virtues of free competition. Professor Eli Heckscher argued for economic liberty on consequentialist grounds. He held that income distribution ought to be as equal as it could be without harming the process of wealth creation,[103] in an anticipation of John Rawls' theory of justice. Heckscher was like Cassel adamantly opposed to protectionism: "Either an economic sector is profitable, and then it does not need tariff protection; or it is not profitable, and then it does not deserve tariff protection."[104] Heckscher contributed to the theory of international trade and wrote a comprehensive history of mercantilism as well as a monumental economic history of Sweden. But to their chagrin, Cassel and Heckscher saw the Social Democrats assume power in 1932, although neither of them probably imagined that they would keep it for 44 years.

Immediately after the Second World War, the Swedish Social Democrats adopted a radical programme of comprehensive economic planning. Swedish businessmen looked on with apprehension and welcomed the translation of von Hayek's *Road to Serfdom*. In Sweden as in many other countries, a lively debate ensued about von Hayek's dire warnings against socialism. One of Sweden's best-known social democrats, political theorist Herbert Tingsten, even changed his mind after reading von Hayek' book. In June 1945 Tingsten said in a famous radio debate on central planning, echoing von Hayek:

> "The problem is whether one can, in a state which directs, leads, plans, and owns most things, preserve freedom in some designated sectors which are then highly taxed. Will such small oases not soon be destroyed by the desert storm which central planning really is?[105]

Tingsten became editor of one of Sweden's largest newspapers where he used his eloquence and wide learning to promote liberal principles. Incidentally, American historian Ralph Raico once recalled von Hayek's dedication of the *Road to Serfdom* to "socialists of all parties", asking: "A noble gesture, perhaps, but what socialist was ever brought over by it?"[106] One answer would be Tingsten.

The lively and even fierce debate in Sweden on central planning at the end of the war (*Planhushållningsdebatten*) was an intellectual victory for the anti-socialists. In order to keep power, the Social Democrats retreated from a radical position. The next two decades saw a new consensus form in Sweden whereby the state refrained from nationalisation and comprehensive economic planning, but instead levied high taxes on the well-off, while mostly avoiding to impair the competitiveness of the export industries. This was the time of the 'Harpsund Democracy' named after the prime minister's summer house where regular consultations took place between leaders of the Social Democrats, the business community and the trade unions. It sometimes felt, critics said, like Sweden was not ruled by her taxpayers and consumers, but by an unholy alliance of Big Government, Big Business and Big Labour. The Social Democrats cautiously started extending welfare benefits to the middle class both to enlarge their own electoral basis and to strengthen support for the welfare state, just like Bismarck had introduced welfare benefits in Germany to try and capture the working class vote. In the 1960s and 1970s, the welfare state seemed to have become firmly entrenched in Sweden, the old liberals quietly falling silent and leaving the scene without younger thinkers or activists replacing them.

In 1976, the Social Democrats had been in power for 44 years (with only a brief break in the summer of 1936). Sweden seemed to be a prosperous, successful country. Left-wing intellectuals around the world looked on her as a role model. Books were written about 'the middle way' or 'the third way' where Sweden seemed to be located. A radical politician, Olof Palme, who had in 1970 become leader of the Social Democrats, was determined to carry further the social reforms started by his predecessors, even if it would mark a departure from the post-war consensus. The emphasis was changing from lifting up the poor to bringing down the rich. Pragmatists were replaced by ideologues. Ambitious plans were made to transfer private enterprises gradually into the hands of the trade unions by means of wage earner funds. Swedish society was to become as socialised and equalised as possible. But as sometimes happens, the time of a movement's greatest triumph is also the time when it may have over-extended itself, gone too far, and has to start a retreat.

What the proponents of the much-touted 'Swedish Model' did not fully appreciate was that it was the earlier liberal Swedish model which had made the country wealthy. Between 1870 and 1936, Sweden had enjoyed the highest growth rate in the industrialised world, whereas in terms of growth between 1936

Swedish Prime Minister Olof Palme visiting Cuban dictator Fidel Castro in 1975. Under Palme the Social Democrats targeted the rich, but the highly redistributive Swedish model of 1970–1990 proved unsustainable.

102 Norberg, How Laissez-Faire Made Sweden Rich.

103 Norberg, *Den svenska liberalismens historia*, p. 229.

104 Ibid., p. 232.

105 Ibid., p. 267.

106 Ralph Raico, Mises and Monarchy, *Liberty* (November 1997).

TABLE 1
Development of Tax Take (% of GDP)

	1955	1965	1975	1985	1995	2005	2015
Sweden	24	31	39	45	46	47	43
Denmark	23	30	38	45	48	50	47
Finland	27	30	36	39	45	42	46
Norway	28	30	39	43	41	43	42
Iceland	N.D.	26	29	28	31	40	36
UK	30	29	34	36	32	34	32
US	24	24	25	25	27	26	26

Source: OECD tax database, Revenue Statistics 2018 Edition.

and 2008 she was only 13th out of 28 industrialised countries.[107] What produced the astonishing growth after 1870 was the introduction of economic freedom into a relatively poor society, but with strong traditions of self-reliance, hard work, thriftiness, respect for the law and a high level of education. Money was sound, with the Swedish *krona* being on the gold standard and Sweden being the leading member of a Nordic monetary union since 1873. The improving infrastructure, such as railways and schools, facilitated economic progress. Swedish entrepreneurs and engineers also rose to the challenge of modernisation. It helped, of course, that Sweden escaped almost all the destruction occurring in other European countries during two world wars. It was in the hundred years between 1870 and 1970 that almost all the internationally known Swedish companies were founded, such as IKEA and Volvo. The environment was friendly to business and taxes were relatively low, even after the Social Democrats took over. In 1955, for example, tax revenues in Sweden, as a proportion of GDP, were the same as in the US, 24 per cent. After this, however the paths of the two countries diverged. In 1975, tax revenues, as a proportion of GDP, had risen to 39 per cent in Sweden, but was still only 25 per cent in the US, as shown in Table 1.

In 1976, internationally acclaimed Swedish novelist Astrid Lindgren who had long been a social democrat wrote a satirical short story on taxation in Sweden after she found herself as a self-employed person paying a 102 per cent marginal tax on her income. Pomperipossa is a children's writer who lives in the beautiful country of Monismania. Suddenly she finds herself paying more than her total income in taxes. The more children around the world who would buy her books, the more the taxes would devour of her assets. Thus, a million or two additional readers would ruin her. The only way out is to stop writing books and go on welfare.[108] The leader of the liberal-conservative Moderate Unity Party, Gösta Bohman, read out the story in parliament. In the same year, a non-socialist government was voted into office in Sweden. It did not however make much of a difference. The three non-socialist parties could not agree on coordinated policies to reduce the tax burden and reform the welfare state. The juggernaut seemed unstoppable.

The Social Democrats, soon back in power, seemed to aim for capitalism without capitalists, a Cheshire cat with only the grin left. The tax system was becoming ever more distortionary. In 1980, for example, a private person owning a business could pay an effective marginal tax of 137 per cent on the return of capital raised by new share issues. Thus, he could lose money by making a profit. If his business was financed by debt, on the other hand, the marginal tax was high, but not expropriatory. If the business was tax exempt, as some institutions and insurance companies were, then it might face a negative effective taxation, a net benefit, mainly because of inflation.[109] The predictable consequence of the social democratic policies was that entrepreneurship diminished. In 2004, 38 of the largest companies in Sweden were entrepreneurial which means that they had been started as privately owned enterprises within the country. Of these 38 firms, 21 were founded before

107 Nima Sanandaji, *Scandinavian Unexceptionalism* (London: Institute of Economic Affairs, 2015), p. 16.

108 Astrid Lindgren, Pomeripossa i Monismanien, *Expressen* 10 March 1976.

109 Sanandaji, *Scandinavian,* pp. 22–3.

In 1976, Astrid Lindgren, world-famous author of children's books, found herself paying 102% tax on her income. More bestsellers would have ruined her. Photo: DPA.

1913 and 15 between 1914 and 1970. Only two had been formed after 1970.[110] While the public sector grew, the private sector stagnated. Between 1950 and 2000, the Swedish population grew from seven to almost nine million. Incredibly, the net job creation in the private sector during this period was close to zero. All the new jobs were in the public sector.[111]

In the 1980s the Social Democrats decided to carry out their plans for the gradual transfer of private enterprises to wage earner funds. They ran however into fierce opposition, and the feeling became widespread that they were going too far. Many entrepreneurs left the country, including the founders of IKEA, Tetra Pak and H&M. Sweden seemed to be becoming more and more like the dystopia Russian-American novelist Ayn Rand describes in *Atlas Shrugged*: The people who create wealth go on strike, not caring to continue working for others without payment—whereas in the marketplace people work for one another according to mutually agreed contracts.[112] But even if Swedish capitalists and entrepreneurs bore a large share of the tax burden, they were not the only ones paying taxes. What may have facilitated the steady increase in taxation, as Swedish economist Nima Sanandaji observes, was that much of it was invisible to the general public. Indirect taxes such as VAT, value added tax, to some extent replaced direct taxes, such as the personal income tax; and many taxes were collected by enterprises even if the final payer was the ordinary wage earner.[113]

It was not only entrepreneurship which was eroded as a result of the overgrown Swedish welfare state, but also the traditional Swedish virtues of hard work, self-reliance, thriftiness, civic participation and social inclusion. As the nation was becoming ever more affluent and healthy in the twentieth century, common sense would have told observers to expect fewer sick-days, fewer people with disabilities and also fewer old people needing financial assistance. In a sense, the point of the welfare state should be to make a welfare state unnecessary. But in 1990, for example, 5 per cent of GDP was spent on sickness and disability programmes in Sweden, 2.3 per cent in Iceland and 2.2 per cent in Switzerland.[114] It is difficult to believe that the explanation was that Swedes were less healthy to this extent than the Icelanders or the Swiss. Shirking has a self-reinforcing effect, both spatially and temporarily. Once some people get away with shirking, the stigma attached to it fades, and their contemporaries start shirking as well. It becomes a way of life. Again, children growing up in a family of shirkers do not learn the skills and acquire the expertise necessary for self-reliance; they become shirkers as well. As Swedish economist Assar Lindbeck

110 Ibid., p. 23.

111 Ibid., pp. 33–4.

112 Ayn Rand, *Atlas Shrugged* (New York: Random House, 1957); Swedish translation *Och jorden skälvte* (Stockholm: Timbro, 1986).

113 Sanandaji, *Scandinavian,* pp. 44–50.

114 Ibid., p. 69.

In *Atlas Shrugged*, Ayn Rand described what would happen when productive groups decide to stop sharing their income with non-productive and even predatory groups. Photo: Library of Congress.

points out, there is, in addition, considerable evidence of explicit benefit fraud in Sweden, for example by people who receive unemployment benefits or sick-pay at the same time as they work, often in the black labour market.

The erosion of traditional values is demonstrated in the World Value Survey. In the 1981–84 survey, 82 per cent of Swedes agreed with the statement that "claiming government benefits to which you are not entitled is never justifiable". In the 1999–2004 survey, the number had gone down to 55 per cent.[115] It should not therefore come as a great surprise that during the 2002 FIFA World Cup, sickness absence among men increased by 41 per cent as compared to women.[116] As a result of this 'drift of norms', social inclusion diminished. Whole groups in society became dependent on the state for their livelihood, such as the long-term unemployed and those on disability benefits and state pensions. They were in such a situation that they did only receive, and not contribute, which had to be detrimental to their dignity and self-esteem, as Hegel saw.

It is true, as Sachs and many other commentators have pointed out, that Sweden is a success story. But it was not the social democratic welfare state which produced better social outcomes than in most other countries. In 1960, for example, the total tax take in Sweden was 29 per cent as compared to 27 per cent in the UK and 34 per cent in Germany. But then life expectancy at birth was the 3rd highest in the OECD nations. In 2005, after the welfare state had been greatly expanded, in Sweden life expectancy at birth was gone down to the 6th place. Clearly, high life expectancy is not created by an extensive welfare state, as Sanandaji observes. He also stresses the fact that Iceland, with a much more moderate welfare state, produces as good or better health results in terms of life expectancy at birth and infant mortality as Sweden.[117] Before the welfare state became big Sweden already had less poverty and a more equal income distribution than most other countries. Studies show that in Sweden inequality dropped sharply in the first 80 years of the twentieth century, before the impact of the extensive welfare state would have been felt. Already in 1920, Sweden had a relatively equal income distribution.

115 Ibid., p. 75. The proportion rose slightly in the next survey, but was 55 per cent in the 2010–14 survey.

116 Assar Lindbeck, Prospects for the Welfare State, IFN Working Paper No. 731 (2008), p. 10. http://www.ifn.se/Wfiles/wp/wp731.pdf Lindbeck quotes a study by Malin Persson.

117 Sanandaji, *Scandinavian,* pp. 54–5.

It is true that redistributive taxation may contribute something to a relatively equal income distribution, but it may also contribute something to social exclusion by creating groups who become dependent on welfare and consequently find themselves locked out of the labour market, as Hegel feared. In the Swedish case the culture of hard work and social cohesion was crucial to the relatively equal income distribution of the early twentieth century. The data suggest that it is more the homogeniety of a nation than government programmes that explains a relatively equal distribution of income. While the Czech Republic and Slovenia for example do not have the same high taxes or generous welfare benefits as Sweden and the other Nordic countries, income distribution there is also relatively equal.[118]

Thus, the Swedish success story had its roots in a combination of economic freedom and a national culture which encouraged hard work, self-reliance, mutual trust and social inclusion. This conclusion is strengthened by not focusing on Sweden alone, but comparing the living standards of Swedes in Sweden and people of Swedish origin in the United States, the descendants of the more than one million Swedes who emigrated before the First World War. This can be done because the US Census asks people to identify themselves in terms of origin. It turns out that on average Swedish-Americans enjoy a higher standard of living than Americans. According to the 2010 US census, the median household income in the US was $51,914, whereas the corresponding figure for Swedish-Americans was $61,549. The main explanation for this difference can hardly be that Swedes generally have better genes than many other groups of immigrants. It has to be culture: the strong tradition in Swedish society of hard work, self-reliance, trust and civic participation, which Swedish immigrants brought with them to North America.

The most convincing argument for the social democratic model was that it could combine security and prosperity, provide generous welfare benefits without any significant harmful effects for economic growth. But it became obvious in the 1970s and 1980s that Sweden was declining materially relative to some other rich countries, in particular the US, as shown in Figure 1.[119] Reluctantly, the Social Democrats started some reforms, deregulating credit and foreign exchange markets and changing the tax system, lowering marginal income tax from 73 to 51 per cent and the capital gains tax to 30 per cent. In 1991 a non-socialist government was voted in again. Now it was also anti-socialist, and it immediately abolished the wage earner funds, transferring the money accumulated there to pension funds and research institutes. It also continued deregulation: energy, postal, telephone, railway and airline markets were all deregulated. The new government however faced a severe banking crisis, with interest rates temporarily going up to 500 per cent in 1992, and a great depreciation of the *krona*. For a while, public expenditures were no less than 73 per cent of GDP.[120] The economy had stopped growing and actually contracted in 1991–1993.

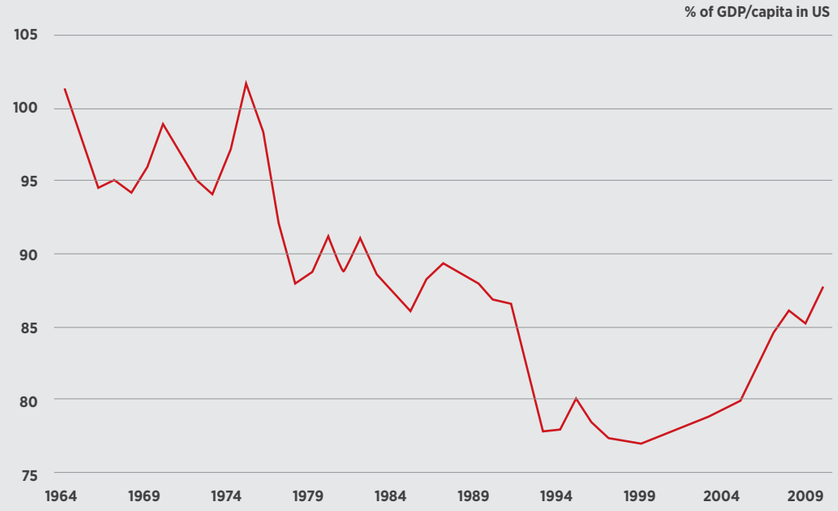
The centre-right government in office responded to the crisis in a typical Swedish fashion, by working with the social democratic opposition which had to admit that cuts in welfare benefits were necessary. The government introduced school vouchers, sold state-owned companies, and carried out reforms in the labour market, favouring small businesses and private job agencies. The government also allowed for some choice in health care and assistance to the elderly. Even if the Social Democrats returned to power in 1994, it was widely accepted that liberal reforms had to be continued. The central bank was made independent; the budget process was reformed; welfare benefits were cut; a new pension system was established, partly with self-funded pensions; collective bargaining was reformed; the inheritance tax was abolished. The centre-right government in 2006–2014 continued liberalising the Swedish economy: the wealth tax was abolished; tax credits were given on earned income; tax deductions were allowed for 'household services'; choice in health care and in assistance to the elderly was extended; property rights were strengthened; the corporate tax was cut to 2 per cent. The Social Democrats who came back into power in 2014 have not tried to reverse these changes.

118 Ibid., pp. 58–60.

119 Purchasing Power Parity Converted GDP Per Capita Relative to the United States, G-K method, at current prices for Sweden. Federal Reserve Bank of St. Louis, Economic Research, website.

120 Data from Nils Karlson of Ratio Institute.

FIGURE 1
SWEDEN'S FALL AND (PARTIAL) RISE



Source: Federal Reserve Bank of St. Louis, Economic Research.

In the 1990s and 2000s, the Swedish economy was liberalised more than almost any comparable economy in the world, the index of economic freedom going from 5.66 in 1980 to 7.67 in 2000.[121] A third Swedish model was now emerging. Individual responsibility and choice have been extended; taxes and welfare benefits have been reduced; markets have been deregulated; companies have been privatised; and private provision of publicly financed welfare services has been introduced. The ideal has however not been abandoned of a safety net where all citizens are guaranteed access to welfare services, even if they are unable to pay for them. Certainly, many problems remain: even if taxes have been reduced, they are still high; the labour market is heavily regulated; housing is also strictly regulated so that there is little construction and low mobility; and freedom of enterprise, especially in services, is restricted. While this new and liberal Swedish model was largely brought about unintentionally by pragmatic responses to the crisis of the unrestrained high-tax welfare state, it enjoys wide support. More people have come to realise that what has made Sweden and the other Nordic countries successful is their combination of open economies, free trade, competitive export industries, protection of property rights and the rule of law on the one hand and social cohesion, transparency, strong traditions, respect for hard work, a high level of trust and homogeniety on the other hand.

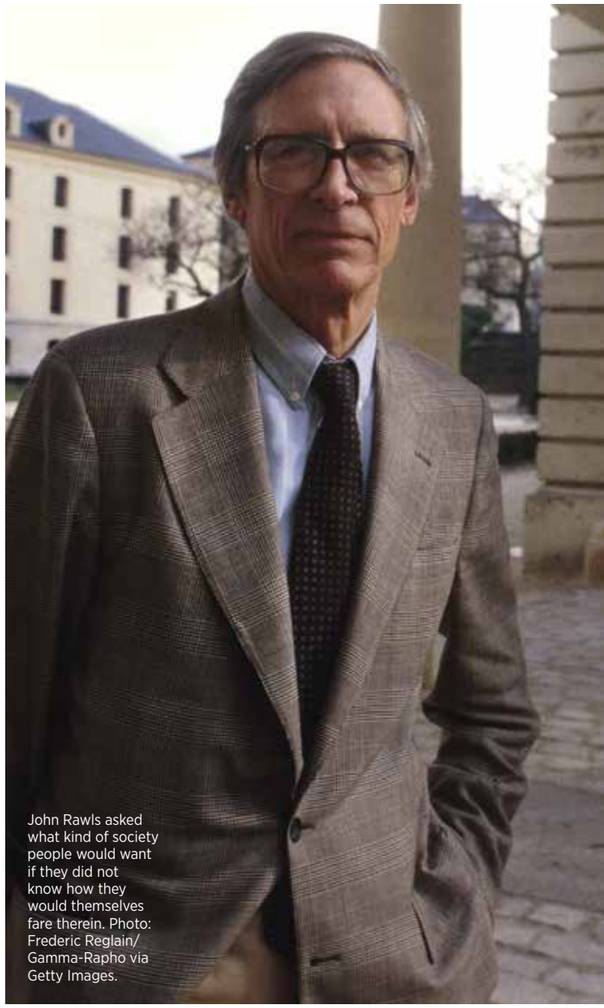
121 James Gwartney et al., *Economic Freedom* (Vancouver BC: Fraser Institute, 2018). https://www.fraserinstitute.org/economic-freedom

6

RAWLS: FOCUSING ON THE WORST OFF

If Georg W. F. Hegel provided the most sophisticated philosophical defence of the welfare state for early nineteenth century, then American philosopher John Rawls did the same for late twentieth century. Both Hegel and Rawls were mostly concerned about the poor and what they considered to be their relative deprivation, but Rawls, a Harvard Professor, approached the problem from the Anglo-Saxon philosophical tradition and with the help of modern economics and game theory. Rawls' *Theory of Justice*, published in 1971,[122] presented, according to British philosopher Stuart Hampshire, "a noble, coherent, highly abstract picture of the fair society, as social democrats see it". It was "the model of social justice", Hampshire added, "that holds the Labour Party together".[123] While Rawls was thus correctly regarded in Europe as a social democrat, in the United States he usually was called a liberal, American social democrats having appropriated the word 'liberalism', as Austrian-American economist Joseph Schumpeter observed: "As a supreme, if unintended compliment, the enemies of the system of private enterprise have thought it wise to appropriate its label."[124]

Rawls offered a variant of the social contract theory, although his contract, unlike that of Locke, was merely hypothetical. Rawls' guiding idea was that the principles of justice for the basic structure of society were those which free and rational persons pursuing their own interests would accept in an initial position of equality. People reasoned in this initial position under a 'veil of ignorance' so that they would leave aside those aspects of society that seemed "arbitrary



John Rawls asked what kind of society people would want if they did not know how they would themselves fare therein. Photo: Frederic Reglain/ Gamma-Rapho via Getty Images.

122 John Rawls, *A Theory of Justice* (Cambridge MA: Belknap Press, 1971).

123 Stuart N. Hampshire, A New Philosophy of the Just Society. Critical Notice of J. Rawls' A Theory of Justice, *The New York Review of Books* 24 February 1972, pp. 34–39. The Notice was anything but critical.

124 Joseph Schumpeter, *History of Economic Analysis* (New York: Oxford University Press, 1954), p. 394.

from a moral point of view", as Rawls put it.[125] None of the persons participating in the bargaining process knew their class position or social status, or their fortune in the distribution of natural assets and abilities, their intelligence or strength. Neither did they know their conception of the good, the particulars of their rational plans of life, or even the special features of their psychology such as aversion to risk or liability to optimism or pessimism. Moreover, they had no information as to which generation they belonged. "They must choose principles the consequences of which they are prepared to live with whatever generation they turn out to belong to."[126] The idea behind Rawls' veil of ignorance is a familiar one: Traditionally, the goddess of justice is shown wearing a blindfold because she is supposed to be objective, not favouring individuals or groups on account of their class position or social status, natural assets and abilities, sex, age, colour or creed. Again, Adam Smith asked us to try and envisage how an 'impartial spectator' could reach objective judgements on moral issues.[127]

Under the veil of ignorance, the contracting parties would, Rawls asserted, "acknowledge as the first principle of justice one requiring an equal distribution. Indeed, this principle is so obvious that we would expect it to occur to anyone immediately."[128] But, Rawls added, "If there are inequalities in the basic structure that work to make everyone better off in comparison with the benchmark of initial equality, why not permit them?" These considerations led him to conclude that "Inequalities are permissible when they maximise, or at least all contribute to, the long-term expectations of the least fortunate group in society."[129] Thus, Rawls held that in the original position the free and rational persons participating in the bargaining process would choose two principles of justice. First, that each person would have an equal right to the most extensive basic liberty compatible with a similar liberty for others. Second, that social and economic inequalities were to be arranged so that they were both (a) reasonably expected to be to everyone's advantage, and (b) attached to positions and offices open to all. The two principles would be in lexical order, the first having priority over the second one: For example, somebody was not allowed to sell his right to vote for a material gain.

A defence of redistribution, or the welfare state, seems to be implied in Rawls' second principle of justice, that social and economic inequalities were to be arranged so that they were reasonably expected to be to everyone's advantage. The stipulation that inequalities were permissible when they maximised, or at least all contributed to, the long-term expectations of the least fortunate group in society, Rawls called 'the Difference Principle'. It led to the 'maximin rule', maximising the minimum, because it stipulated that society should be arranged in such a way that the worst off would be as well or better off as they could be under any alternative arrangements. The main reason why the blindfolded persons in the original position would play it safe and choose the maximin rule would be somewhat akin to considerations discussed in Chapter 3: In a world of uncertainty, it is more reasonable to prepare for the worst than to hope for the best. Therefore democratic institutions are designed to survive bad, even evil, rulers, however rarely they might be elected or otherwise gain power. Therefore, also, ships are built for rough seas even if such weather is an exception rather than the rule. "People who dream about a socialist society rarely consider the possibility that some of those other people may succeed in imposing their ends on the dreamer, instead of the other way around. George Orwell is the only exception who comes to mind," David Friedman notes.[130] Rawls may be another exception: He said that his two principles of justice were those a person would choose for the design of a society in which his enemy was to assign him his place.[131]

Rawls' theory of justice is Georgism in persons. We recall from Chapter 2 that Henry George thought it unjust that only the Californian landowners, and not the public, benefitted from a rise in the price of land as a result of gold discoveries, since they had not contributed anything themselves. They did not deserve the rise in price. Therefore George suggested a single tax on land which would capture all 'unearned increment' from it. Rawls' change of emphasis reflects the fact that nowadays control over natural resources such as land, forests, gold mines or oil wells, seems to determine income distribution even less than it did in the nineteenth century. What really matters in modern society, for social prestige as well as income, is 'human capital' rather than physical capital. It is individual ability to render services to others, entrepreneurial alertness, professional expertise, looks, sex appeal, intelligence, prowess in sports, skill in human relations, adaptability, wit, artistic talent, perspicacity, sound judgement and so on. The reason why successful individuals should not necessarily enjoy increased income on account of their 'superiority' was precisely, according to Rawls, that this was a gift, just like the superiority of a plot of land in George's scheme of things: While some people were born into better circumstances or with more talent than most, without deserving it, others were "less fortunate" or disadvantaged, not necessarily through any faults of their own. Rawls therefore rejected what Adam Smith had called the system of natural liberty. "Intuitively, the most obvious injustice of the system of natural liberty is that it permits distributive shares to be properly influenced by these factors so arbitrary from a moral point of view," Rawls observed.[132]

Two ideas expressed by Locke can be found in Rawls' theory, albeit in different forms. One is about the enormous benefits from social cooperation. This is the reason Rawls thought that there was something to distribute. He wrote that

> "since everyone's well-being depends upon a scheme of cooperation without which no one could have a satisfactory life, the division of advantages should be such as to draw forth the willing cooperation of everyone taking part in it, including those less well situated. Yet this can be expected only if reasonable terms are proposed.[133]

Rawls believed that his two principles of justice would be a fair agreement on the basis of which those better endowed or more fortunate could expect the willing cooperation of others. The other idea was about proper compensation. Locke had argued that the vast increase in the total product brought about by the introduction of private property rights did more than to compensate those who had not been able, for whatever reason, to appropriate anything of the unowned resources in the original state of nature. Rawls, on the other hand, thought that the less endowed, worse situated or disadvantaged would agree to his proposed social contract, if they could rest assured that they would benefit more from the utilisation of the superior endowments and situations of others than they would under any alternative arrangements. Thus, they would be fully compensated for their disadvantages and could not complain that the system was unjust.

The first thing to note about Rawls' theory is that paradoxically it is not about justice, as traditionally understood in political philosophy.[134] When Aristotle for example spoke about justice in distribution or rectification it was in connection with people operating in particular institutions or situations, not the whole of society. For Aristotle, distributive justice was really about injustice: It was about somebody not getting his or her proper share of something that was being distributed, be it money, punishment, praise or prestige.[135] The traditional sense of justice was neatly expressed in the old legal maxim, *Honeste vivere, neminem laedere, suum cuique tribuere*, or, Live honourably, harm no one, give everyone his due.[136] Rawls' theory, on the other hand, is about prudence. Fearing the worst instead of hoping for the best, the blindfolded participants in the bargaining process make a strategic decision to minimise possible repercussions of ending up amongst the worst off in society. It is a cogent argument, but for prudence rather than justice. And it should be qualified to leave some room for taking risk. People who make risky investments, bet on horses, play in the lottery and go to casinos, are not necessarily being irrational. Some may even earn their livelihood by dealing with high

125 Rawls, *Theory,* p. 15.

126 Ibid., p. 137.

127 Smith, *Moral Sentiments*, Part I, Section 1, Ch. IV, §6–8.

128 Rawls, *Theory,* pp. 150–151.

129 Ibid., p. 151.

130 David D. Friedman, *Machinery*, p. 22.

131 Rawls, *Theory,* p. 152.

132 Ibid., p. 72.

133 Ibid., p. 15.

134 I am certainly not alone in thinking this. Antony Flew, *The Politics of Procrustes: Contradictions of Enforced Equality* (London: Temple Smith, 1981), pp. 81–82; John R. Lucas, *On Justice* (Oxford: Clarendon Press, 1980), p. 186.

135 Aristotle, *Nicomachean Ethics* [340], Bk. V, 1, §8–10.

136 *The Digest of Justinian* [530–533], ed. Alan Watson (Philadelphia PN: University of Pennsylvania Press, 1985), Vol. I, Bk. I, Sect. 1, 10.

risks, for example currency speculators and some asset managers, not to forget stuntmen, acrobats and other entertainers. There are also those who may think, given the choice, that a society where winners could expect to go far (say Hong Kong) is more attractive and exciting than a society with generous provisions for losers (say Norway). Could the people under the veil of ignorance not be expected to agree to a basic maximin rule (perhaps in the form of a safety net set as high as possible) with a 'maximax rule' (allowing the best endowed to maximise their earning abilities) superimposed on it?

One weakness of Rawls' theory is that he seems arbitrarily to exclude economic liberties from his first principle of justice stipulating as much liberty for each as would be compatible with a similar liberty for others. Why should the freedom to buy and sell goods and services be worth less than freedom of expression? Rawls replied that in modern times economic goods have become less important than civil liberties. As the general level of well-being rises, "only the less urgent wants remain to be satisfied by further advances." What increases is our insistence on "the right to pursue our spiritual and cultural interests."[137] But this is a value judgement, perhaps typical of a tenured university professor, and not an argument. It is not obvious to me that the blindfolded people in the original position would make this value judgement and decide to exclude economic liberties from the first principle of justice. It is however obvious why Rawls chose to do so on their behalf. If he had included economic liberties, then he would have ended up with Adam Smith's system of natural liberty, as the first principle has priority over the second. If Rawls would respond that economic liberties would imply more risks than the persons in the original position were prepared to accept, then it should be noted that his civil liberties, for example the freedom of expression, also carry some risk.[138]

Rawls may also have been inconsistent in his claim that those inequalities in the basic structure that would work to make everyone better off in comparison with the benchmark of initial equality would be accepted by the people in the original position. If there is a benchmark of initial equality, then the question is where it lies. In comparison to what are the worst off as well off as they could be? A plausible answer would be: at the income which the severely handicapped could produce which would more or less amount to zero. Consider the positions of two persons, Able and Infirm, under the basic structure. Able produces a lot, and Infirm almost nothing. Under the veil of ignorance, a dialogue is played out. Able promises Infirm that he will make both of them better off but only if he himself gets a bigger share. But the agreement was, Infirm says, that justice required equality. Able responds that equality is just a benchmark. To make him work harder he has to get a bigger share. Infirm asks why. Able must admit that this is because he pursues his self-interest and would only work harder if he gets a bigger share. But this means that he does not pursue justice as understood in Rawls' scheme. It also means that he may keep the income he earns by working hard, or almost all of it, provided he does not make Infirm worse off or only slightly better off. He is, in other words, entitled to his income, or almost all of it. Able might drive a hard bargain: He would only give Infirm 0.1 per cent of his income and keep the remaining 99.9 per cent.[139] What is there on Rawls' premises to hinder that? Thus, it is not at all certain that the difference principle "guarantees a satisfactory income", as Rawls assumed.[140]

Again, what is there to share? Rawls spoke as if the total product of a society was at the disposal of the persons in the original position, as a result of the enormous benefits for all from social cooperation. But as Robert Nozick notes, Rawls did not make a clear distinction between that part of the total product what is clearly privately created and that part which may be the additional gain from social cooperation.[141] Assume that ten Robinson Crusoes are stranded on ten separate islands, without any means of trading or otherwise cooperating and communicating with one another. The years pass and the castaways become settlers. Some are joined on their islands by people like Man Friday, making a division of labour possible

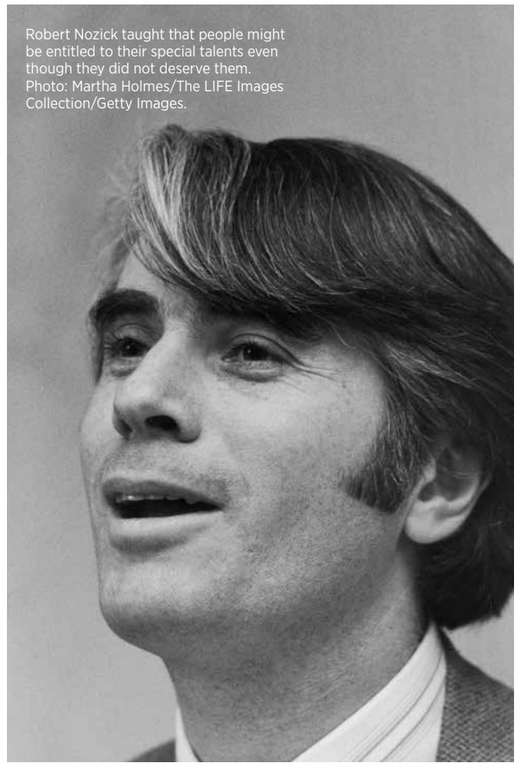
137 Rawls, *Justice,* pp. 542–543.

138 Jan F. Narveson, Rawls on Equal Distribution of Wealth, *Philosophia,* Vol. 7, No. 2 (1978), pp. 281–292.

139 Op. cit. Also, Palmer, *Realizing,* pp.98–100.

140 Rawls, *Justice,* p. 156.

141 Nozick, *Anarchy,* p. 184.



Robert Nozick taught that people might be entitled to their special talents even though they did not deserve them. Photo: Martha Holmes/The LIFE Images Collection/Getty Images.

with the consequent increase in the total product of their islands. Others are joined by Woman Friday, so that they can be fruitful and multiply and benefit even more from the division of labour and enclosure of land and other resources. Some are quick learners and hard workers, acquiring various skills, constructing buildings and accumulating goods. Others are slothful and barely survive. Some islands also turn out to be more fertile than others. After 28 years — which was the time the hero of Daniel Defoe's novel spent on his island — suddenly the inhabitants of the ten islands are able to join forces, to trade and cooperate, perhaps because the most enterprising islander was able to build a ship and now offers transport between the islands at low cost.[142] It is difficult to see how the inhabitants of the poorer islands could somehow lay claim to a part of the total product of the richer islands at that time, or why the inhabitants of the richer islands should feel compelled in the name of justice to contribute to the inhabitants of the poorer islands, although they might do so out of compassion. At least they would not refer to the benefits from social cooperation in the archipelago.

If there is anything to distribute, then at most it would be that part of the total product of the archipelago which would result directly from the trade and other cooperation between the ten islands after their economic and social integration and which would be in addition to the part produced separately on each of the islands.[143] While it certainly may constitute the major part of the total product, it is not somewhere to be found as if it was a cache of gold on a treasure island. The goods available for exchange or gifts in the archipelagos, such as wood, cottages, boats, tunics, wine, bread, coconuts, fish, books, games of football, violin concerts, and philosophy lectures, come into the world already attached to individuals. At any given time, then, there would already exist a distribution of goods in the archipelago, the unintended consequence of a myriad of market transactions, including gifts and bequests. Therefore, what Rawls really demanded was the enforced redistribution of those goods, transferring them from those who now possess them to others. If the argument for redistributing this part of the total product is that it is brought about by social cooperation and that it is difficult or even impossible to disentangle what each contributed to the increased product, then the response is that it is actually possible and perhaps not too difficult to disentangle different contributions. They are reflected in market prices. An income distribution brought about by market transactions roughly will reflect the marginal product of each person active in the marketplace, in other words the perceived value for others of a person's actions and services.[144]

We rarely stumble upon unowned treasures. Certainly, when the Israelites were wandering through the desert, on their way from Egypt, Yahweh provided them with the bread called 'manna'. The rule the wandering tribe used to divide up this gift from heaven was simple: Everybody took what he or she needed for the day, no more and no less, which meant that the portions were roughly equal.[145] But

142 Daniel Defoe, *The Life and Strange Surprizing Adventures of Robinson Crusoe, Of York, Mariner: Who lived Eight and Twenty Years, all alone in an un-inhabited Island on the Coast of America, etc.* (London: 1719: William Taylor).

143 The inspiration for this story of the ten islands is Nozick, *Anarchy,* p. 185.

144 Hayek, *Constitution,* p. 87.

145 Exodus, 16, 16–17.

in modern society, there is no manna from heaven. In the marketplace, income distribution is by choice: You buy, sell, give, bequeath or otherwise dispose of your holdings, and so do others, and the unintended aggregate consequence of all these transactions is called 'income distribution': it is an end result, even if continually changing, and not an activity. In a large, complex society, there is no central distributor, no pile of goods somewhere waiting to be distributed. Philosophers are fond of pointing out that if a mother is dividing up a cake between her children, she would normally give equal portions to each of them, whereas other possibilities would call for justification.[146] But the reason for the equal division lies in the situation: the mother has the cake and the children are all equally her children. She would not be expected to give the same portions to children of strangers, and she could of course not divide up any cake if it had not already been baked and at her disposal. What this example tacitly presupposes is a thriving, busy bakery providing people with their daily bread, including cakes that mothers can cut for their children.

It seems not true, either, that differences in treatment always have to be justified. Consider the Parable of the Workers in the Vineyard. A landowner went out at dawn to hire labourers for his vineyard. Agreeing with them for the usual daily wage, somewhat later in the morning he saw others standing idle in the marketplace and hired them also. He did the same about noon and yet again in the early afternoon. Around five o'clock he found others standing around. He asked them: "Why do you stand here idle all day?" They answered that no one had hired them. The landowner told them to go into his vineyard. When it was evening, he told his foreman to summon the labourers and give them their pay, beginning with the last and ending with the first. To the great surprise of the labourers, all received the same payment. Those who had been working from dawn grumbled against the landowner, complaining that they had borne the day's burden and the heat. The landowner replied that he was not cheating them. They had agreed with him for the usual daily wage. "Am I not free to do as I wish with my own money? Are you envious because I am generous?"[147] There may be good reasons why the landowner paid all the same which amounted to vastly different hourly rates, for example that he was anxious to finish a project before the next day or that he took pity on the labourers standing about idle in late afternoon, while he did not want to humiliate them by giving them handouts and instead hired them for a short period. But the crucial point in the Parable of the Workers in the Vineyard is that you are not cheating anyone if you keep your word with them. You are otherwise free to do as you wish with your own money, because it is your money and you are a free person. You are not allowed to be unjust, to be sure, but in a free society you can go beyond justice and be generous. This is a possibility largely ignored by Rawls and other egalitarians.

Rawls wanted to impose a pattern, the maximin rule, on income distribution: the only inequalities permissible are those involving a gain for the worst off. But as Nozick observes, liberty would upset all such patterns whether they are supposed to work for the worst off, as stipulated by the minimax rule, or some other groups. Let us return to our archipelago of ten islands, now having enjoyed for a long time the benefits of the division of labour and free trade and therefore having become quite affluent and populous. Assume that somehow the income distribution there, D_1, satisfies the criterion a philosopher like Rawls has constructed of a just income distribution. Milton Friedman, an eloquent advocate of individual choice, goes on a tour of the archipelago, charging 50 dollars per person for his lectures, in addition to costs. People flock to his lectures, with 500 persons attending each of them. After the tour, Friedman is richer by 250,000 dollars whereas each member of his audiences is poorer by 50 dollars. The income distribution in the archipelago has changed from D_1 to D_2. Income inequality has increased. But Friedman's listeners are all satisfied with what they got. They could say, with the landowner in the Parable of the Workers in the Vineyard: "Am I not free to do as I wish my own money?" Where is the injustice? Who is being done down? To make the same point, Nozick uses the basketball player Wilt Chamberlain,[148] and before him, William Buckley the baseball player Joe DiMaggio.[149] In every case when an attempt would be made to

146 Isaiah Berlin, Equality, *Proceedings of the Aristotelian Society,* Vol. LVI (1956), repr. in *Concepts and Categories* (London: Hogarth Press, 1978), pp. 81–102. Cf. Rawls, *Theory,* p. 85.

147 Matthew, 20:1–16.

148 Nozick, *Anarchy,* pp. 160–161.

149 William F. Buckley, *God and Man at Yale* [1951] (South Bend IN: Gateway Editions, 1986), p. 57.

The Workers in the Vineyard by Rembrandt. If the vinyeard owner paid the workers the wage agreed, he was just. If he paid some of them more than their due, he was generous.

impose a pattern of distribution upon a whole society, liberty would upset such a pattern, for example if you desire more money than allotted under the scheme and start to work late hours in your garage, producing goods or providing services for your neighbours. As Nozick quips, "The socialist society would have to forbid capitalist acts between consenting adults."[150]

Moreover, Rawls' theory of prudence under the veil of ignorance seems in some ways to be at odds with justice in the traditional sense. Rawls rejected Locke's chief premise, self-ownership, on the ground that the distribution of abilities is morally arbitrary: While some are endowed with intelligence, or beauty, or strength, others are born stupid, ugly, frail or handicapped. Neither Able nor Infirm in our dialogue deserved what they got. But most of us would think that attributes such as intelligence, looks or strength form integral parts of an individual's personality, however unevenly they may have been distributed among people. Assume that a technology could be developed to do eye transplants. You have two eyes, as a normal person does, and I have just empty sockets. A more equal distribution of eyesight would be that one eye would be transferred from you to me. But most people would find this abhorrent, at least if enforced.[151] After all, these are your eyes. They belong to you. They are an integral part of your personality. So are your other endowments. It is a misfortune rather than an injustice that some people are born with less intelligence or strength or other such abilities than others. Consider sex appeal: While it is very unevenly distributed, it certainly has a great impact on life. Nevertheless, few would follow Praxagora in Aristophanes' *Assemblywomen* when she wanted to distribute sexual favours equally: "The ugly men will have to tail the handsome men as they leave their dinner parties, and keep an eye on the public places, for it won't be lawful for the tall and handsome to sleep with any women who haven't first accommodated the uglies and the runts."[152]

150 Nozick, *Anarchy,* p. 163. Probably from Murray Rothbard, A Future of Peace and Capitalism, *Modern Political Economy*, ed. by James H. Weaver (Boston: Allyn and Bacon, 1973), pp. 419–430.

151 Nozick, *Anarchy,* p. 206.

152 Aristophanes, *Assemblywomen* [390 BC], repr. in *Three Plays by Aristophanes,* trans. Jeffrey Henderson (London: Routledge, 2010), p. 176.

Perhaps an individual does not strictly speaking deserve to be born with some abilities most others do not enjoy. He or she may however be entitled to them, as Nozick holds.[153] They form a part of his self, his personality. And surely it matters how he or she develops such abilities. Here redistributionists like Rawls encounter the same difficulty as the Georgists did about land: how to separate the contributions of the owner and nature. Personal abilities are more than simply natural endowments. Two singers are born with equally deep expressive bass voices. One trains his voice to perfection, the other one lives a life of sloth and waste, gradually losing the ability to sing. As Thomas Edison said, "Genius is one per cent inspiration, ninety-nine per cent perspiration."[154] Even good looks helping people to succeed may be partly the result of a healthy lifestyle and careful grooming. Moreover, from the premise that you did not deserve the abilities with which you were born it does not necessarily follow that *others* deserve them or that you do not deserve the *income* which can be derived from the use you make of them. Possibly people under a veil of ignorance might agree that in an affluent society the citizens should be taxed in order to maintain a minimum level for all, a safety net, but it is difficult to see wherefrom the less endowed would gain a permanent and unconditional right through no effort of their own to a share in the wealth created by others.[155] They certainly do not deserve it. Also, even if you may not deserve your abilities, you may be entitled to them and thus you may indeed deserve the income you derive from developing them, for example Friedman from giving lectures and Wilt Chamberlain from playing basketball.[156]

Rawls' theory was about an end state, not a process. It was therefore ahistorical. But justice in the traditional sense is not least about what has in fact happened and who was responsible for it. It is about giving everybody his or her due. Consider the worst off. Most people would think it relevant how they came to be that way. If I am in a wheelchair because I was foolhardy in the past, then I have myself to blame. If I am poor because I am a loafer, a wastrel, a gambler or a drunkard, then I can hardly claim that you should compensate me. Fyodor Dostoyevsky was frequently in dire straits because of his gambling habit. Oscar Wilde died, as he lived, beyond his means. Perhaps similar considerations apply if you are promiscuous and contract a venereal disease whose treatment you then cannot afford. Would the help you might receive from others in this case be in the name of justice, or of charity? There are of course the 'deserving poor', as the Victorians called those who were poor but were not responsible for their condition. But there are also the undeserving poor.[157]

Rawls might have agreed with much of this. While he did not offer a definition of the worst off in his theory of justice, he mentioned that they might be in the position of the unskilled worker, with the average income of that group, or less. Or that they were all the persons with less than half of the median income in a society (which is the traditional definition of relative poverty).[158] In later writings he however suggested that they might be thought of as those who had not been favoured by their origin, endowment or luck.[159] This is an important addition to the theory because it means that he was mainly referring to the deserving poor, and how they came, through no fault of their own, to be in the condition of the worst off. But then desert has entered the theory. The reason why the worst off had to be compensated by takings from the best off was that they had not deserved their condition. I have already argued that even if people may not have deserved their natural endowments, they may be entitled to them and that they may also deserve the income they can derive from them. On first sight, family origin or social status may be more plausible justifications for redistribution. The child born in a Mumbai slum or Rio favela will have few opportunities. But if we recognise the institution of the family, then we also have to accept that it is the source of some inequality which may be inevitable: Some parents provide better for their children than others, not only and perhaps not most importantly by money transfers. If we do not want to dissolve families, we can do little about this problem except conceding that basic education may be a public good, to be financed by taxpayers. Moreover, it seems not to be my fault if you have more children than you can adequately provide for.

From a moral point of view, luck, whether good or bad, seems also to be undeserved. The race is not always to the swift. The Parisian scribe who lost his job because Gutenberg invented the printing press in the 1430s, did not deserve his bad luck,[160] nor did the worker in a Detroit car plant that could not cope in the 2010s with competition from Japan or South Korea. The same applies to victims of earthquakes, floods, hurricanes, volcanic eruptions and other natural disasters. Probably it was also bad luck for a person desiring a quiet life to be born in the first half of the twentieth century, as Lev Trotsky once remarked. But in modern society emergency funds and insurance companies are set up to help people in distress. And Paris scribes and Detroit workers have to heed the advice of Milton Friedman. When I in 1984 introduced him at a luncheon in Reykjavik to a governor of Iceland's Central Bank, telling him that this person would become unemployed if the Icelanders implemented his monetary proposals, Friedman quickly responded: "No, he would not become unemployed; he would just have to move to a more productive job." The Paris scribes and Detroit workers have to move to more productive jobs. It may be difficult, but it is not impossible, especially not in a dynamic economy.

Bad luck is certainly undeserved, but it is not injustice. It is rather a task or a challenge. Indeed, one of the flaws in Rawls' theory is that it is static rather than dynamic. It does not take sufficiently in account the market as a process rather than an end state. It would seem to matter, for example, whether the worst off find themselves in a temporary situation or not. In a growing, dynamic economy with a lot of immigrants arriving penniless, but soon becoming affluent, a low-income group would not necessarily call for pity or involuntary transfers from others. Another example would be if the low-income group consists of young people now acquiring a skill which later will enable them to earn a good income. Here again we find a contrast between two approaches to poverty: one is to make it bearable, the other one is to create incentives for people to get out of it, which might include insisting on poverty remaining unpleasant.

Milton Friedman giving a talk in Iceland in 1984. If people flock to his lectures, happily paying him a fee, his income rises. But where is the injustice?

153 Nozick, *Anarchy,* pp. 150–163.

154 Martin A. Rosanoff, Edison in His Laboratory, *Harper's Magazine,* Vol. 165 (September 2932), p. 406. Edison apparently said this in 1902.

155 Flew, *Politics*, p. 79.

156 Ibid., p. 105.

157 Digby Anderson, *The Unmentionable Face of Poverty in the Nineties—Domestic incompetence, improvidence, and male irresponsibility in low income families* (London: IEA Social Affairs Unit, 1991).

158 Rawls, *Theory,* p. 98.

159 Rawls, *Political Liberalism* (New York NY: Columbia University Press, 1993), pp. 83–84.

160 The scribes' guild in Paris managed to delay the introduction of the printing press into their city for 20 years. Bernhard J. Stern, Resistances to the Adoption of Technologicial Innovations, *Technological Trends and National Policy* (Washington DC: Government Printing Office, 1937), p. 48.

Hayek adds an important consideration about income distribution. Wages are prices. They perform the same function as other prices: they are signals telling you where to go. While necessary, incentives are not sufficient. Surely you run faster if you hope for a carrot and fear the stick. But whereto should you run? Income distribution in a free society transmits information to people about which abilities they should develop if they want to earn a living by serving other people's needs. Redistribution of income, beyond laying out a safety net, greatly distorts such signals.[161] I cannot see how Rawls can plausibly answer von Hayek's point. Surely people make their plans according to expected income after tax, not before. Swedish author Astrid Lindgren enjoyed as much to write for children as they liked to read her books. But when she had to pay a 102 per cent tax on her income, a series of future bestsellers by her would have been disastrous.

Yet another serious problem in Rawls' theory is about the definition and extension of the society on whose structure the blindfolded persons in the original position are agreeing. Are the worst off living in an affluent nation state? Or are they members of Western society, stretching from Central and Western Europe to North America? Or is the frame of reference the whole world? Or even the whole universe? In the political theories of von Hayek and Nozick, say, this hardly makes a difference because enforceable obligations to other people are mainly negative, about respecting their rights, refraining from doing anything to them. But in Rawls' theory if you are among the worst off, you have a right to a part of the income of the better off. Why should the respect for persons stop at borders? In 2017, the average income (GDP per capita) in Singapore was $57,700, in Norway $75,500, in Switzerland $80,200 and in the United States $59,500. On the other hand, it was $800 in Haiti, $1,700 in North Korea, $500 in the Democratic Republic of Congo and $400 in the Central African Republic. The average income per capita in the two most populous countries of the world was $8,800 in China and $1,900 in India.[162] We should recall that these are averages; in poor countries the worst off of course have much lower incomes. Even if Rawls' proviso is taken into account that the transfer of money from the rich to the poor must not worsen the condition of the poor, an enforced redistribution on an enormous scale seems to be called for if the social contract would be extended to the whole world. After all, what have unskilled workers in Massachusetts or Michigan done to deserve their vast advantages over the poor in Haiti or Congo? If we would then suddenly discover another inhabited planet where people are much worse off than we are, would we then acquire an obligation to share our wealth with them? Or if the inhabitants there turn out to be much better off than we, would we then have a claim on their wealth?

If however, Rawls confines the social contract to the affluent nation state in the West, even if it is in an abstract sense, then the problem of exit arises. Could those who create wealth decide to leave like those rich people in Sweden who in the 1970s and 1980s moved to Switzerland? Or perhaps form their own societies, as envisaged in Ayn Rand's *Atlas Shrugged*? Rawls could not allow this, and when he was later refining and revising his theory, he wrote that his society was closed, "in that entry into it is only by birth and exit from it is only by death."[163] Rawls' political programme is, in other words, 'Socialism in one country,' as I discuss in more detail in Chapter 10. Liberalism, on the other hand, has always been cosmopolitan, welcoming the ability to move to and from different countries, sometimes for pleasure or sheer curiosity, sometimes in the pursuit of better economic opportunities.[164] The attempt to remove exit as an option, even if it may logically follow from the nature of the bargain struck in the original position under the veil of ignorance, demonstrates yet again the underlying idea that the abilities of the better endowed should at least partly expropriated.

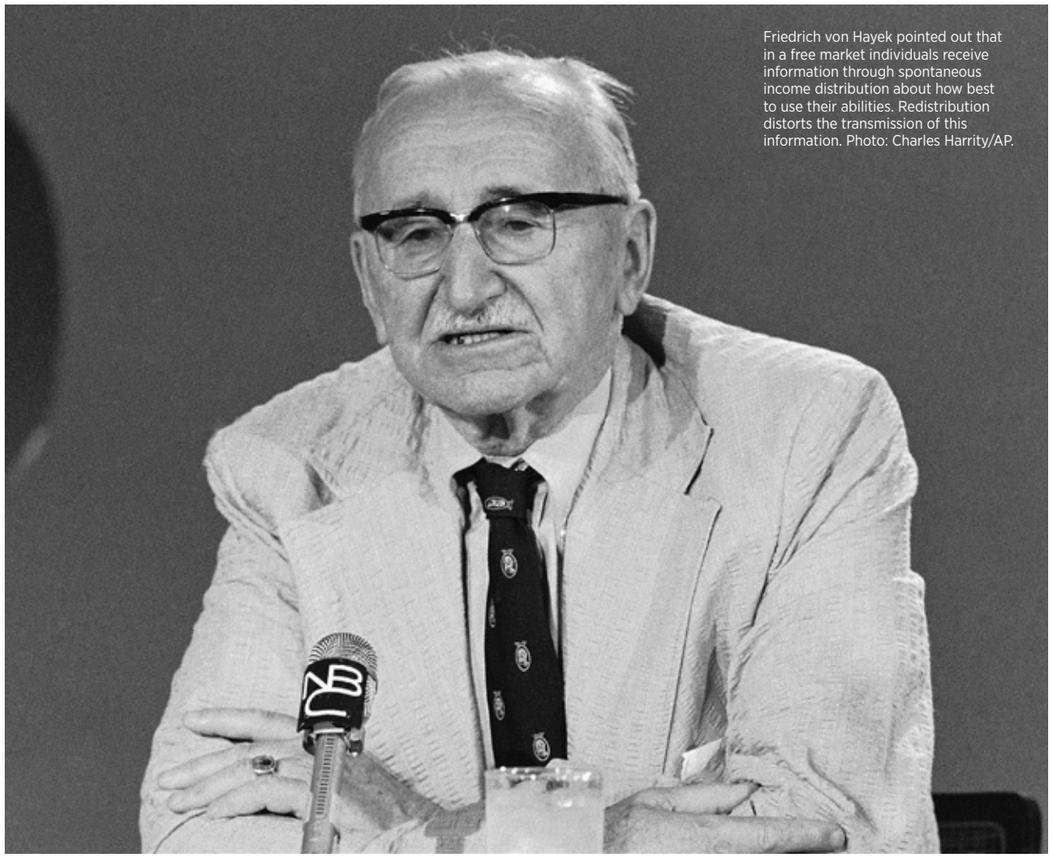
I conclude that Rawls may have provided a cogent argument for a strategy of preparing for the worst instead of hoping for the best if people are choosing a future structure of society without knowing where they would be placed there themselves. But this does not amount to an argument that income has

161 Hayek, The Muddle of the Middle, *Philosophical and Economic Foundations of Capitalism*, ed. by Svetozar Pejovich (Lexington MA: D. C. Heath and Company, 1983), p. 91. This paper has the same content as a lecture under the same name that Hayek gave in Iceland on 2 April 1980.

162 World Bank. GDP per capita, current US$ (online), except the estimate for North Korea, *The World Factbook* (Washington DC: Central Intelligence Agency, 2018).

163 Rawls, *Liberalism,* p. 41.

164 Palmer, *Realizing,* pp. 95–138.



Friedrich von Hayek pointed out that in a free market individuals receive information through spontaneous income distribution about how best to use their abilities. Redistribution distorts the transmission of this information. Photo: Charles Harrity/AP.

to be redistributed in the name of justice, except in the rather limited sense of financing a safety net and producing some public goods, defence, public security and primary education. Justice is not about maximising the income of the poorest segment of the population. It is about giving everybody their due, whether they are man or woman, white or black, intelligent or stupid, industrious or lazy, healthy or sick, strong or weak, rich or poor. Rawls' rejection of self-ownership was also counter-intuitive. We cannot separate the person from his or her personal attributes, like intelligence, looks or strength. Rawls did not take seriously the distinction between persons.[165] Justice is not prudence, and bad luck in one's parents, endowments or course of life does not necessarily amount to injustice. You are not acting unjustly if some one else is born handicapped, whereas you are acting unjustly if you are a judge and do not mete out punishment according to the merits of the case, or if you are a teacher and you do not grade students according to the quality of their tests or papers. (It is different, though, when you are using your own money, as we saw in the Parable of the Workers in the Vinyard.) It may be too much to claim that the free market order is just, in the traditional sense. But it is plausible to say that it is *not unjust*. As Aristotle and many other philosophers have observed, it is the 'negative' notion of injustice which defines, determines or circumscribes the 'positive' notion of justice, like peace is best understood as absence of war and freedom as absence of coercion.[166] And if justice is regarded as absence of injustice, then the social and political order based on individual choice, on the equal freedom of all, on Locke's enclosures that make nobody worse off and on Smith's trade for mutual benefit, in short the system of natural liberty, can be said to be just. There people are spending their own money.

165 This is of course Rawls' own objection to utilitarianism. *Justice,* p. 27.

166 Aristotle, *Nicomachean Ethics*, Bk. V, I, §5–12; John Stuart Mill, *Utilitarianism* [1863], Ch. V, §3, repr. in *Collected Works,* Vol. X (Toronto: University of Toronto Press, 1996); Hayek, *Law, Liberty, and Legislation,* Vol. II (London: Routledge & Kegan Paul, 1976), p. 36; Lucas, *On Justice*, p. 4.

7

APPLYING THE RAWLSIAN TEST

John Rawls' theory of justice seems somewhat parochial. Rawls closed his eyes and tried to imagine himself without any prejudices, personal preferences or special interests. When he opened the eyes again, what he saw was the social structure more or less of his home town of Cambridge, Massachusetts, with full freedom of speech, relative affluence and moderate redistribution of wealth. He was not unlike Hegel who thought that history moves in steps, by thesis, antithesis and synthesis, and that the ultimate synthesis was the Prussian officialdom (*Beamtenstaat*) of his own time; no further steps apparently were envisaged. Indeed, his compatriot Friedrich Nietzsche quipped that "for Hegel the highest and final stage of the world-process came together in his own Berlin existence."[167] Nevertheless, even if Rawls may not have succeeded in providing a comprehensive and coherent defence of justice in the redistributive state, his contribution to political philosophy is important in at least three ways. First, he clearly demarcated an upper limit to redistribution: If the worst off become even worse off as a result of redistributive measures, then these measures are self-defeating and irrational. The goal of redistribution, as Rawls saw it, is to help the worst off, not necessarily to harm the best off. In the second place, Rawls engaged in a meaningful dialogue with the poor on how society could be made acceptable to them, agreeing with Hegel that the task was to integrate them into society, although he, like Hegel, may have underestimated the resources within a free market order for social integration, such as autonomous associations, social mobility, and poverty alleviation through economic growth.

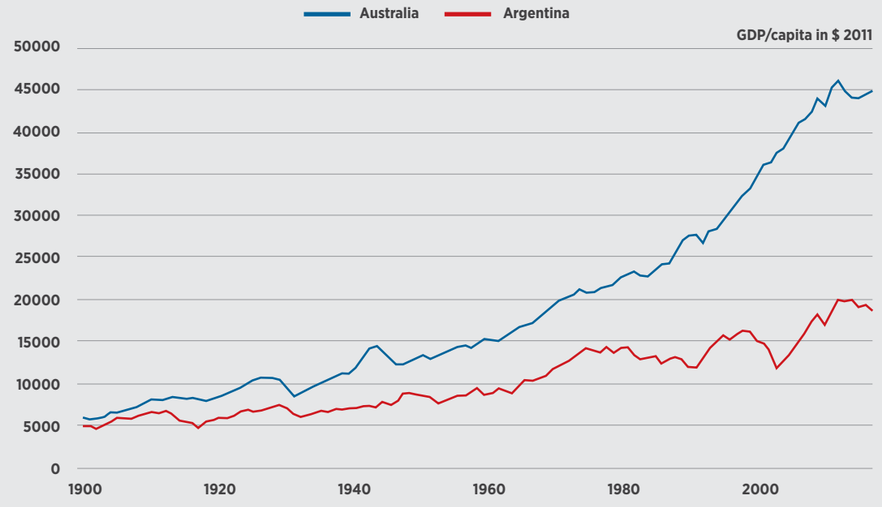
Thirdly, Rawls conducted a useful thought experiment: In what kind of society would you choose to live if you were uncertain of your own status therein? Friedrich von Hayek was confronted with such a question when he was living in England during the Second World War:

> "It was at that time, when we were all prepared for much worse than eventually happened, that I received offers from several neutral countries to place my then small children with some unknown family with whom they would presumably remain if I did not survive the war. I had thus to consider the relative attractiveness of social orders as different as those of the USA, Argentine and Sweden, on the assumption that the conditions in which my children would grow up in that country would be determined more or less by chance. This led me, as abstract speculation perhaps never could have done, to realize that where my children were concerned, rational preferences should be guided by considerations somewhat different from those which would determine a similar choice for myself who occupied already an established position and believed (perhaps wrongly) that this would count for more in a European country than in the USA. Thus, while the choice for myself would have been influenced by the considerations of the relative chances for a man in his early forties with formed skills and tastes, a certain reputation and with affiliations with classes of particular inclinations, the choice for my children would have had to be made in consideration of the particular environment in which chance was likely to place them in one of those countries. For the sake of my children who still had to develop their personalities, then, I felt that the very absence in the USA of the sharp social distinctions which would favour me in the Old World should make me decide for them in favour of the former.[168]

167 Friedrich Nietzsche, Vom Nutzen und Nachteil der Historie für das Leben, *Unzeitgemäße Betrachtungen* [1874], §8, *Werke*, Vol. 1 (München: Hanser, 1954), p. 262.

168 Hayek, *Law, Legislation and Liberty,* Vol. II, pp. 188–189.

FIGURE 2
THE WIDENING GAP BETWEEN AUSTRALIA AND ARGENTINA 1900–2016



Source: Maddison Project Database, version 2018 (online). Real GDP per capita in 2011 dollars.

Hayek would have chosen the United States rather than Sweden or Argentine because he felt that his children would have fewer barriers to overcome. American society was more open. It was less interested in your accent or origins than in the services you could provide.

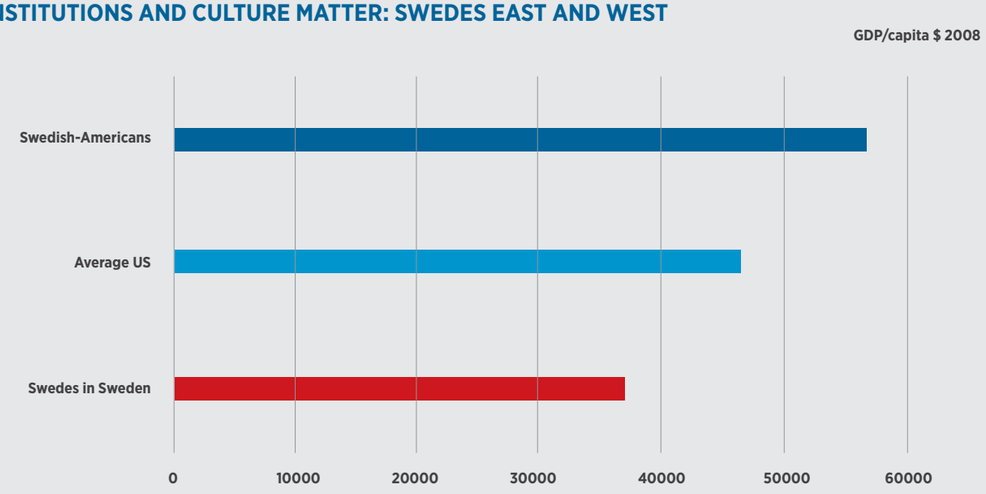
The Rawlsian test was of course slightly different: How fares the worst off? It is nevertheless a pertinent question. Let us take a brief look at the three countries mentioned by von Hayek. Argentine's history in the twentieth century was no less than a tragedy. She is the only country in the world which was 'developed' in 1900 and 'developing' in 2000. In the beginning of the twentieth century she was one of the ten richest countries in the world. In 1950, the ratio between GDP per capita in Argentine and the average in OECD countries was 84 per cent; in 1973 it had fallen to 65 per cent; and in 1987 it was only 43 per cent. It is instructive to compare Argentine and Australia because they are both inhabited almost solely by European immigrants, both large countries with ample natural resources, and both with a similar climate, in the Southern hemisphere. If anything, Argentine is more fertile than Australia, as the old and rather unkind joke shows: God created Argentine, but when He saw how generous He had been, He hastened to create the Argentines. Figure 2 shows the development of GDP per capita in these two countries since 1900 — the year of Australian independence, Argentine having become independent in 1816.[169] It is true that Argentine was hit hard by the Great Depression starting in 1929, but so was Australia. The history of Argentine after 1929 has been characterised by political instability, with military dictators and elected presidents alternating, but with practically all of them sharing an ideology of corporatism and import substitution, some under the baleful influence of Argentine economist Raúl Prebisch. A brief return in the 1990s to liberal principles failed. The extraordinary relative decline of Argentine has generated much scholarly literature, but its main causes should be obvious: protectionism and redistributionism. Protection of domestic industries removed the incentive and information needed to be internationally competitive. Not only did redistribution reduce long-term investment, but when it proved too costly to be financed by taxes, demagogues in power printed money and brought about inflation, increasing the already serious economic instability in the country and distorting the price system.[170]

169 Maddison Project Database, version 2018 (online). Jutta Bolt, Robert Inklaar, Herman de Jong and Jan Luiten van Zanden, Rebasing 'Maddison': new income comparisons and the shape of long-run economic development (2018).

170 Sebastian Edwards, *Left Behind: Latin America and the False Promise of Populism* (Chicago: University of Chicago Press, 2013), pp. 143–164.

FIGURE 3

INSTITUTIONS AND CULTURE MATTER: SWEDES EAST AND WEST



Sources: OECD and Nima Sanandaji.

Thus, while Argentine may have been a possible choice in the first half of the twentieth century, later the real alternatives would have been the two other countries mentioned by von Hayek, Sweden and the United States, which are also to some extent 'ideal types' or different models of welfare capitalism. In Chapter 4 we saw that the Swedish success story had its roots in a combination of economic freedom and a national culture which encouraged hard work, self-reliance, mutual trust and social inclusion. I pointed out that the Swedish immigrants to the United States brought this culture with them, so that they enjoyed higher than average income. Another comparison is relevant. It is between Swedes in Sweden and Swedes in North America. It turns out that Swedish-Americans enjoy a higher standard of living than Americans on average, and a much higher standard of living than the Swedes in Sweden. The difference in living standards, as measured by GDP per capita, is shown in Figure 3, with data from 2008.[171] More recent data show the same. According to the 2010 US census, the median household income in the US was $51,914, whereas the corresponding figure for Swedish-Americans was $61,549. It has also been calculated that absolute poverty (in dollars or kronor rather than as a proportion of total income) is less in Sweden, 9.3 per cent, than in the US, 11 per cent. But it has been consistently found for decades that descendants of Nordic immigrants in the US have roughly half the poverty rate of average Americans which means that they have lower poverty rates than Nordic citizens.[172] In other words, Swedish-Americans are more affluent and less poor than Swedes in Sweden. This suggests that von Hayek may have been right in choosing, under something like a Rawlsian veil of ignorance, the United States for his children rather than Sweden.

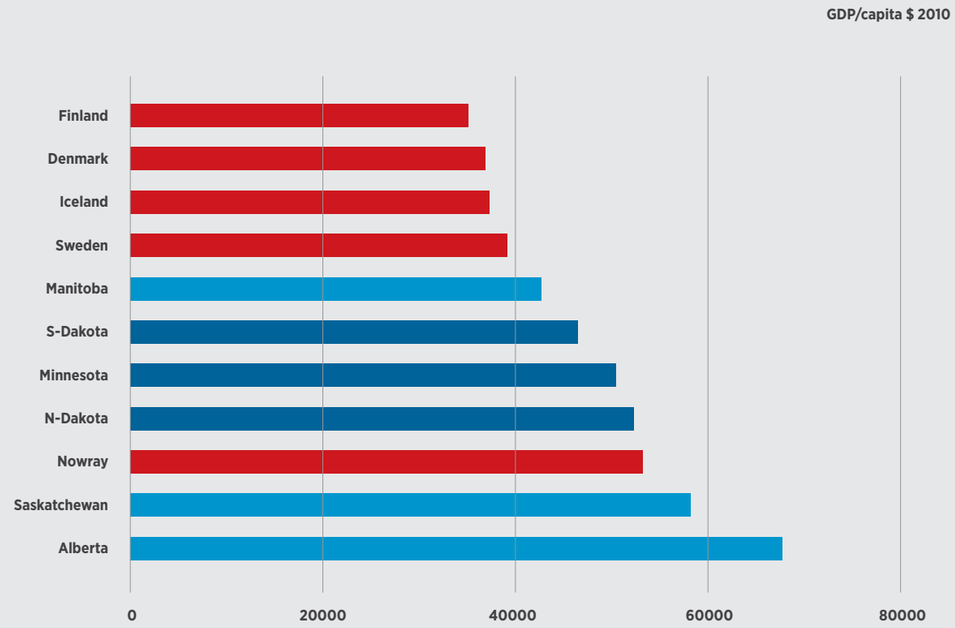
Sometimes, when the United States, a federation of 50 states, or Canada, a country consisting of 10 provinces, are compared to European countries, data relevant to a Rawlsian test might get lost. The European Union has 28 member states. Where would Sweden be ranked in terms of GDP per capita if it suddenly left the EU and became the 51st state of the US? Swedish economists Fredrik Bergström and Robert Gidehag have provided a surprising answer, using data from 2000–2001: Sweden would have been one of the poorest states of the US. It would have had a little less GDP per capita than Alabama, ranking

171 Data on the US and Sweden, OECD 2009. GDP per capita: US$, using current PPPs, in *OECD in Figures*. Paris: OECD Publishing. Data on Swedish-Americans, Nima Sanandaji, *The surprising ingredients of Swedish success — free markets and social cohesion*. (London: Institute of Economic Affairs, 2012), p. 21.

172 Sanandaji, *Scandinavian,* pp. 61–64.

FIGURE 4

ELEVEN NORDIC ECONOMIES, EAST AND WEST



Sources: CIA World Factbook; Canada Statistics, US Bureau of Economic Analysis.

slightly above Mississippi and West Virginia, the two poorest states in the US. Bergström and Gidehag also pointed out that the living standards of the poor in the US, in terms of material benefits such as household appliances and access to modestly priced restaurants, are better than in Sweden.[173]

I have made another comparison, using data from 2010, between the five Nordic countries and six North American states and provinces, three in the US and three in Canada, all located in the northern part of the continent and inhabited to some extent by Nordic immigrants. It turns out, as shown in Figure 4, that the North American countries in the sample are all wealthier than the four Nordic countries and that the oil-rich Canadian provinces are wealthier than oil-rich Norway.[174] In many ways, the quality of life is also as good or even better in those three North American countries as in the Nordic countries.

It is not unlikely that the living standards of the poorest 10 per cent in Sweden, expressed in GDP per capita, would be roughly similar to those in the 'Nordic' countries in North America. The difference is however that the rich in the 'Nordic' North American countries are much richer. This would presumably imply that the North American countries would offer greater opportunties to escape poverty, for example by rendering services to the rich or by accepting scholarships to Harvard from the rich. In other words, on Rawlsian principles, focusing on the worst off, it would be probably be reasonable to prefer the 'Nordic' countries in North America to the Nordic countries in Europe, however counter-intuitive it may seem.

Perhaps these examples, while interesting, are too anecdotal. They may not be sufficient to answer the question posed by Rawls: In what kind of society could the worst off expect to be best off over time?

173 Fredrik Bergström and Robert Gidehag, *EU versus USA* (Stockholm: Timbro, 2004), http://www.timbro.se/bokhandel/pdf/9175665646.pdf Fredrik Bergström, Europe versus the USA, *Cutting Taxes to Increase Prosperity* (Reykjavik: Bokafelagid, 2007), pp. 41–60.

174 Canadian data (Table A.34 gross domestic product per capita, provinces and territories, in current dollars) from Canada Statistics for 2009–2010. The data are in C$ which was then almost equal to US$. See www.statcan.gc.ca Data on Nordic countries from *CIA World Factbook* (GDP per Capita, PPP, USD) 2010. Data on states in the US from J. E. Avery, T. P. Siebeneck and R. P. Tate, Gross Domestic Product by State. Advance Statistics for 2010 and Revised Statistics for 2007–2009. Price level 2010. Bureau of Economic Analysis (2011). See www.bea.gov

A more general approach may be required where special conditions cease to be relevant. The data for such an approach are provided by the 'Index of Economic Freedom' which has been developed by Milton Friedman, Canadian economist Michael Walker and American economist James D. Gwartney, author of a widely-used textbook in economics,[175] with a group of assistants. Friedman and his colleagues tried as hard as they could to use objective data, preferably from international organisations, and to make it totally transparent.

The 2018 Index of Economic Freedom uses data from 2016 in five areas: 1) *Size of Government.* As government spending, taxation, and the size of government-controlled enterprises increase, government decision-making is substituted for individual choice and economic freedom is reduced. 2) *Legal System and Property Rights.* Protection of persons and their rightfully acquired property is a central element of both economic freedom and civil society. Indeed, as Locke argued, it is the most important function of government. 3) *Sound Money.* Inflation erodes the value of rightfully earned wages and savings, as we saw in Argentine and many other countries. Sound money is thus essential to protect property rights. When inflation is not only high but also volatile, it becomes difficult for individuals to plan for the future and thus use economic freedom effectively. 4) *Freedom to Trade Internationally*. Freedom to exchange, in its broadest sense, buying, selling, making contracts, and so on, is essential to economic freedom, which is reduced when freedom to exchange does not include businesses and individuals in other nations. 5) *Regulation.* Governments not only use a number of tools to limit the right to exchange internationally, they may also develop onerous regulations that limit the right to exchange, gain credit, hire or work for whom you wish, or freely operate your business.[176]

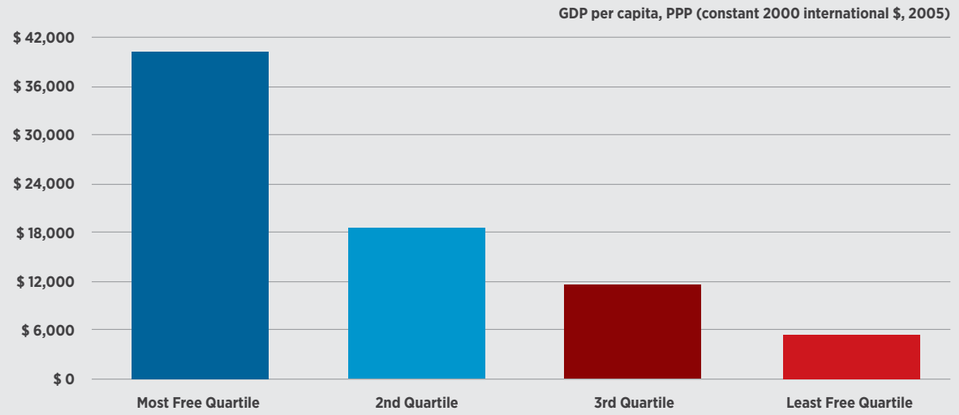
Adam Smith's economic theory is convincingly supported by the Index of Economic Freedom. Statue in Edinburgh. Photo: Adam Smith Institute.

The data on economic freedom are available for 123 countries for every year in 2000–2016 and for approximately 100 countries back to 1980. The ten, or rather eleven, countries with the freest economies in 2016 were:

- Hong Kong
- Singapore
- New Zealand
- Switzerland
- Ireland
- United States
- Georgia
- Mauritius
- United Kingdom
- Australia and Canada (a tie)

It is noteworthy that of these eleven countries no less than nine were at one time or another subject to British rule, and thus partaking of the British political tradition, besides the United Kingdom herself Hong Kong, Singapore, New Zealand, Ireland, the United States, Mauritius, Australia and Canada. Indeed, Hong Kong could be called 'Adam Smith's Other Island'.[177] The case of Mauritius is quite intriguing. In 1961, when the country was still a colony, British economist and later Nobel Laureate James E. Meade, a committed social democrat, had done a study for the island's administration, concluding that the prospects for an independent state there were bleak. Mauritius might get locked in a Malthusian poverty trap.[178] Eleven years later, the West Indian writer and later a Nobel Laureate in Literature, Vidia Naipaul, contemptuously dismissed the island as an "overcrowded barracoon" where everybody wanted to leave. "It was on Mauritius that the dodo forgot how to fly."[179] The people of Mauritius, gaining independence in 1968, proved both pundits wrong. This remote island has made much faster progress than other African countries. It should also be pointed out that of the Nordic countries, in 2016 three were in the top quartile of economic freedom, Denmark, Finland and Norway, whereas Sweden and Iceland were in the second quartile.

FIGURE 5
INCOME PER CAPITA IN DIFFERENT ECONOMIES 2016



Source: Economic Freedom of the World 2018.

The ten countries with the unfreest economies in 2016 were on the other hand:

- Sudan
- Guinea-Bissau
- Angola
- Central African Republic
- Republic of Congo
- Syria
- Algeria
- Argentina
- Libya
- Venezuela

Seven of these countries were in Africa, two in Latin America and one in the Middle East. The two remaining communist countries in the world, Cuba and North Korea, undoubtedly have even unfreer economies than Venezuela, but they were not included in the survey, as no reliable data were available from them.

The Index of Economic Freedom can be used to gain insight into the correlation with other magnitudes or numbers. Some results thus obtained are stunning. It is economic freedom which produces prosperity. The average GDP per capita in the top quartile of economic freedom was $40,376 in 2016, compared to only $5,649 in the bottom quartile, as measured in PPP (Purchasing Power Parity) 2011 US dollars. This is illustrated in Figure 5. On other criteria of wellbeing

175 James D. Gwartney, *Economics: Private and Public Choice* (Cincinnati OH: South-Western Cengage Learning, 2014, 15th ed.).

176 James Gwartney, Robert Lawson, Joshua Hall, and Ryan Murphy, *Economic Freedom of the World: 2018 Annual Report* (Vancouver BC: Fraser Institute, 2018).

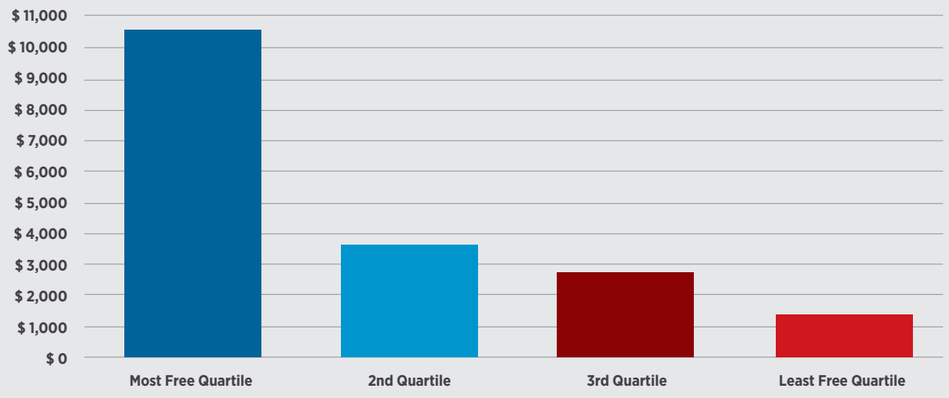
177 Alvin Rabushka, *Hong Kong: A Study in Economic Freedom* (Chicago: Chicago University Press, 1979).

178 James Meade, *The Economics and Social Structure of Mauritius. Report to the Government of Mauritius* (London: Methuen, 1961).

179 V. S. Naipaul, *The Overcrowded Barracoon: And Other Articles* (London: André Deutsch, 1972), p. 256.

FIGURE 6

INCOME PER CAPITA OF POOREST 10% IN DIFFERENT ECONOMIES 2016



Source: Economic Freedom of the World 2018.

such as life expectancy, political and civil liberties, gender equality and happiness levels the countries in the top quartile of economic freedom also score much higher on average than those in the three other quartiles. The data from the survey have been used in many scholarly studies. "Virtually without exception, these studies have found that countries with institutions and policies more consistent with economic freedom have higher investment rates, more rapid economic growth, higher income levels, and a more rapid reduction in poverty rates."[180]

What is most interesting for our purposes, as we are applying the Rawlsian test, is the situation of the worst off. We recall that Rawls suggested that they could be defined as those with the income and wealth of unskilled workers, or less, or all persons with less than half of the median income and wealth. It is clear that on such assumptions the worst off would be much better off in the top quartile of economic freedom than in any of the three other quartiles. A Rawlsian would have to choose a model of capitalism similar to that found, say, in Hong Kong, Singapore, New Zealand and Hong Kong. This may be too facile, though. Let us therefore define the worst off narrowly, as only the 10 per cent with the lowest income. How does this group fare in different types of economies? The answer to this question is also stunning. In the top quartile, the average income of the poorest 10 per cent in 2016 was $10,660, compared to $1,345 in the bottom quartile, as measured in PPP constant 2011 US$. Interestingly, the average income of the poorest 10 per cent in the most economically free nations ($10,660) was almost twice the average income per capita in the least free nations ($5,649).

A similar result is obtain when we look at the proportion of people in different economies who have income below the threshold of $3.20 a day (in 2016 dollars). This would be one way of measuring absolute poverty. In the freest quartile it is 4 per cent. In the other three quartiles, moving in the direction of less freedom, the proportion is 14, 29 and 51 per cent. The contrast is stark: 4 per cent living in absolute poverty in the freest economies and 51 per cent in the unfreest economies.

However, there seems to be no clear correlation between economic freedom and the share by the poorest 10 per cent in GDP. It is 2.7 per cent on average in the freest economies, and in the other three quartiles, moving in the direction of less freedom, the share is 2.4, 2.5 and 2.5 per cent. This means that inequality is not a necessary corollary of capitalism: the share by the poorest in the total product of a society does not increase with more economic freedom. An often discussed possible

180 For a review of these studies, Joshua Hall and Robert Lawson, Economic Freedom of the World: An Accounting of the Literature, *Contemporary Economic Policy,* Vol. 32, No. 1 (2014), 1–19.

In 2016, Hong Kong had the freest economy in the world. It has done much better than the economy of Mainland China, without human sacrifices.

trade-off between equality and efficiency therefore does not seem to be necessary. To those who care about the condition of the poor rather than their social position this is not important anyway. "Poverty is about not having *enough* rather than about having *less*."[181] It is however noteworthy that even on this criterion the freest economies seem to be the most egalitarian ones although the relationship admittedly is quite weak. I cannot but conclude that if von Hayek were to decide here and now where to place his children, he would choose a society with a relatively free economy: the opportunities are much greater there than in the unfree economies. It is also difficult to see how Rawls could avoid making the same choice: the worst off are much better off under capitalism (as it is fair to call the freest quartile of the world's economies) than under interventionism or socialism. it is a telling fact that the poorest 10 per cent under capitalism have more than tenfold the average income of people in the unfreest quartile.

Capitalism passes Rawls' test, according to the Index of Economic Freedom. But there is another and no less important test of political system: what real people tend to choose. Capitalism passes that test even more clearly. People generally want to move from less to more economic freedom. One of my teachers at Oxford, Amartya Sen, once criticised inequality in the United States in a lecture. I raised my hand and objected: "Isn't the United States also a country of great opportunity?" His only answer was: "Ah, so you are one of those who believe in the land of the free and the home of the brave!" A few students chuckled. But for two hundred years the United States has been a magnet attracting people from all over the world as well as a great melting pot, successfully integrating different people from distant places. This great country showed, at least in the nineteenth century, that Adam Smith was not far off when he said to his students: "Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things."[182] It is perhaps not surprising that egalitarians have changed their emphasis, from poverty to inequality, as we shall now see.

181 Loren Lomasky and Kyle Swan, Wealth and Poverty in the Liberal Tradition, *The Independent Review,* Vol. 13, No. 4 (2009), p. 495.

182 Smith, Lecture in 1755, quoted in Dugald Stewart, Account of the Life and Writings of Adam Smith [1794], repr. in *Essays on Philosophical Subjects* (Indianapolis IN: Liberty Fund, 1982), p. 322.

8

PIKETTY: PRIVATE WEALTH AS SOCIAL EVIL

The hefty tome by French economist Thomas Piketty, *Capital in the Twenty-First Century,* published in 2014, became an instant success with left-wing intellectuals. Whereas some of them had not identified with the communist regimes in Central and Eastern Europe that they saw collapsing in 1989–1991, they were dismayed by what they regarded as the rise of 'neo-liberalism' in the whole world: the move towards more economic freedom in countries as diverse as Thatcher's Great Britain, social democratic New Zealand and Chile under military dictatorship.[183] Even Communist China to some extent re-introduced private ownership of the means of production and liberalised her economy, the index of economic freedom for China showing 3.6 in 1980 and 6.3 in 2010. Disheartened by this course of events, left-wing intellectuals eagerly seized on the international financial crisis of 2007–2009 as evidence for the fundamental instability of capitalism. But in addition, they needed a theoretical justification for fettering capitalism. This was provided, many of them thought, by Piketty's book, its title intentionally echoing that of Karl Marx' *Capital*. Piketty did not propose revolution like Marx, but rather the confiscatory taxation of the rich who otherwise would, he asserted, appropriate all capital, bringing back something like the early nineteenth century patrimonial society described by Honoré de Balzac and Jane Austen. Underpinning his radical proposal was a theory of how the gulf between rich and poor, capital and labour, was bound to widen if nothing was done. This theory was backed by impressive and extensive empirical studies of two centuries of economic history, with the relevant data made available online.

Piketty's message was that economic inequality was increasing, and that this was caused by capitalism:

> When the rate of return on capital exceeds the rate of growth of output and income, as it did in the nineteenth century and seems quite likely to do again in the twenty-first, capitalism automatically generates arbitrary and unsustainable inequalities that radically undermine the meritocratic values on which democratic societies are based.[184]

Calling the rate of return on capital *r* and the rate of growth *g*, Piketty held that *r* was usually larger than *g*, *r* > *g*. "This fundamental inequality will play a crucial role in this book. In a sense, it sums up the overall logic of my conclusions."[185] Defining capital as "the sum total of nonhuman assets than can be owned and exchanged on some market",[186] Piketty regarded capital accumulation by the rich as an almost inevitable historical outcome of unbridled capitalism:

> The inequality *r* > *g* in one sense implies that the past tends to devour the future: wealth originating in the past automatically grows more rapidly, even without labor, than wealth stemming from work, which can be saved. Almost inevitably, this tends to give lasting disproportionate importance to inequalities created in the past, and therefore to inheritance.[187]

183 Charles Moore, *Margaret Thatcher: The Authorized Biography,* Vols. 1–2 (London: Allen Lane, 2013–2015). Vol. 3 is still to be published. One of the most prominent reformers in New Zealand was Sir Roger Douglas, Labour Finance Minister in 1984–1988, whose policies went under the name 'rogernomics'. Roger Douglas and Louise Callen, *Toward Prosperity* (Auckland: David Bateman, 1987).

184 Piketty, *Capital in the Twenty-First Century* (Cambridge MA: Belknap Press, 2014), p. 1.

185 Ibid., p. 25.

186 Ibid., p. 46.

187 Ibid., p. 377.

Thomas Piketty wants to bring down the rich rather than to lift up the poor. He claims to have identified a trend towards the runaway accumulation of capital. Photo: Sho Tamura/ AFLO/Alamy Live News.

Capital accumulation by the rich had been halted in early twentieth century, Piketty said, by two world wars, the Great Depression and redistribution in the welfare state, but with the return to policies similar to those pursued in the nineteenth century, not least tax reductions for the rich, it had resumed. However, capitalism had to be constrained rather than abolished. Therefore progressive taxes should be imposed, 80 per cent on high income and 5 per cent on great wealth. These taxes had to be global, so that there would not be any escape by exit.

In France, Piketty had been economic adviser to the Socialist Party. Probably under his influence, President François Hollande in 2012 had imposed a 75 per cent tax on high-income executives, but the Socialist leader had been forced to abandon it in the beginning of 2014, as it was unpopular and produced meagre returns. With his book, Piketty gained international recognition, like John Rawls forty years earlier. But there was a crucial difference between the two. Rawls was mainly worried about poverty which most people would regard as a social evil to be reduced as much as possible. Piketty on the other hand is worried about wealth. For him the problem seems to be that some people are richer than other, much richer, not that some are poorer. His solution is to impose confiscatory taxes on the rich to 'rectify' the situation, the "arbitrary and unsustainable inequalities that radically undermine the meritocratic values on which democratic societies are based." It is difficult to distinguish this kind of egalitarianism, focusing on bringing down the rich instead of lifting up the poor, from envy, one of the seven capital sins. In practical terms, envy is that if someone else enjoys a good which you do not have, you would rather that neither of you enjoys it. Usually, envy is condemned, "that most anti-social and odious of all passions," as John Stuart Mill commented.[188] Envy is not supposed to play a part in moral reasoning, although there are of course mild bouts of envy that people can overcome. "Whenever a friend succeeds, a little something in me dies," American writer Gore Vidal remarked, perhaps half in jest.[189] Such emotions can even encourage

188 John Stuart Mill, *On Liberty* (1859), Ch. IV.

189 Susan Barnes, A profile of Gore Vidal, *The Sunday Times Magazine,* 16 September 1973.

those who have them to try and do better. But there is also malicious envy, a desire to see others deprived of something. "It is not enough to succeed. Others must fail," English novelist William Somerset Maugham once said.[190]

Sometimes envy is not only malicious, but also deadly. Because God favoured Abel, his brother Cain killed him.[191] There is a famous incident in one of the Icelandic sagas which well illustrates the destructive nature of envy. The two poets Gunnlaug Serpent-Tongue and Hrafn Onundson compete for the favours of Helga the Fair. When Gunnlaug is abroad Hrafn uses the opportunity to marry her. Gunnlaug returns to Iceland, and it becomes obvious that Helga is really in love with him. The two poets become bitter enemies. Travelling to Norway to evade an Icelandic ban on duelling, they fight, and Gunnlaug manages to chop off one of Hrafn's legs. Out of kindness, Gunnlaug then brings his wounded rival some water from a nearby brook after Hrafn promises not to trick him. Hrafn reaches out his left hand for the water, but with his right hand he hacks Gunnlaug with his sword. When Gunnlaug exclaims that he has been cruelly deceived, Hrafn replies: "I did it because I would not have you receive the embrace of Helga the Fair." They continue their fierce duel, and both lose their lives.[192] Hrafn's emotion is malicious, deadly envy. If I cannot have it, then I shall see to it that it will be denied to you too. Of course the egalitarianism based on envy is not as dramatic as the ancient stories of Cain and Abel or Hrafn and Gunnlaug. It is about 'soaking the rich'. But unlike Piketty, Rawls explicitly dismissed any such egalitarianism.

If Piketty was worried that the poor did not have capital, then he could have written a book about how to develop a 'property-owning democracy' by facilitating the access by workers to capital and by removing inequalities created by government intervention. But left-wing intellectuals typically tend to oppose schemes such as Margaret Thatcher's initiatives in the United Kingdom to allow tenants in council houses to buy them on favourable terms or to offer employees of public companies to buy shares in them at a discount. It should also be noted that pension funds where workers are supposed to be the chief beneficiaries are now major shareholders in many businesses in Western economies. In 2017, pension fund assets amounted to 183 per cent of GDP in the Netherlands, 152 per cent in Iceland and 148 per cent in Switzerland.[193] Piketty argues that *capitalism* generates inequalities which the state should reduce, but it would seem more urgent to remove the inequalities that the *state* generates.[194] Trade restrictions such as tariffs and quotas favour owners and employees of the industries being protected and reduce the living standards of ordinary consumers. The same applies to immigration, on the premise that the immigrants are arriving to find work rather than to receive welfare benefits.

The state generates many other inequalities. Occupational licensing, whether it is of medical doctors, public accountants, plumbers or hairdressers, transfers money from consumers to providers of the licensed services. Complicated tax codes, allowing deductions of home mortgages and charitable contributions, tend to favour high-income earners. Intellectual property rights, such as patents, copyrights and trademarks, generate more inequalities than may be necessary to reward innovators and artists. While Piketty, in a discussion about Bill Gates, implicity recognises the role of patents in creating monopoly rents,[195] he draws the wrong conclusion: that Gates's wealth should be confiscated by the state (instead of allowing him to give it away, as he is doing), not that rules on patents should be revised.[196] Again, agricultural subsidies in the European Union and the United States not only raise food prices, they also benefit local farmers enjoying decent living standards relative to dirt-poor farmers in less developed countries.

190 Iris Murdoch, *The Black Prince* (London: Chatto and Windus, 1973), p. 98.

191 Genesis, 4:1–18.

192 The Saga of Gunnlaug Serpent-Tongue, *The Complete Sagas of Icelanders,* Vol. I (Reykjavik: Leifur Eiriksson Publishing, 1997), p. 330–331.

193 *Pension Funds in Figures* (Paris: OECD, 2018), p. 1.

194 Jeffrey Miron, The Role of Government in Creating Inequality, *Anti-Piketty: Capital for the 21st Century* (Washington DC: Cato Institute, 2017), pp. 193–202.

195 Piketty, *Capital,* p. 563.

196 Cf. Hayek's discussion of patents, copyrights and trademarks in his opening address at the founding meeting of the Mont Pelerin Society, April 1947, 'Free' Enterprise and Competitive Order, repr. in *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), pp. 107–118. Repr. in *The Collected Works of F. A. Hayek,* Vol. 4, *The Fortunes of Liberalism* (Indianapolis IN: Liberty Fund, 2008), pp. 237–248.

On average, members of elites live longer and take greater interest in the education of their children than others. Therefore, public subsidies to pension funds and non-compulsory schools favour them over low-income groups. The same applies to subsidies to opera houses, symphony orchestras, and museums, mostly enjoyed by 'highbrow' people. If it is protested that such subsidies favour mainly, and only moderately, the middle class and not the super-rich, then it should be pointed out that star athletes like Wilt Chamberlain benefit by public funding of stadiums and other sports facilities and activities. Best-selling authors, and their heirs, like Agatha Christie and Astrid Lindgren (and for that matter Piketty himself) also benefit from copyrights. Moreover, executives of financial firms—who often draw enormous salaries—greatly benefit from the reluctance by government to apply the same rule to such firms as to other businesses: that if you repeatedly make mistakes, then you fail. If commercial banks and investment funds are big enough, or 'systemically important', then in a financial crisis government comes to their rescue, with taxpayer money. The implicit rule therefore becomes: When everything is fine, you enjoy the benefits; when things go wrong, government bears the cost. Profit is privatised and loss socialised.[197] The argument for bank rescues is that otherwise depositors would panic. In other words, in the US context, Wall Street uses depositors as human shields against Main Street. But in a report on the 2008 Icelandic bank collapse I pointed out that the Icelanders found a way to avert panic without necessarily rescuing bankers. This was to give deposits priority over other claims on the estates of banks.[198] What the star athlete, best-selling author and financier have in common is that their revenues are augmented by government intervention without any apparent need to do so.

Piketty only takes into account physical capital or wealth: the two are equivalent in his theory. But in addition to physical capital, the stock of plants, equipment, machines and tools, there is human capital, the stock of productive skills, talents, health and expertise of the labour force.[199] Education can at least partly be regarded as investment in human capital: people acquire skills in order to improve their chances in the labour market. This was explicitly recognised by Adam Smith when speaking about the acquired and useful abilities of all the inhabitants in a country:

> The acquisition of such talents, by the maintenance of the acquirer during his education, study, or apprenticeship, always costs a real expence, which is a capital fixed and realized, as it were, in his person. Those talents, as they make a part of his fortune, so do they likewise that of the society to which he belongs. The improved dexterity of a workman may be considered in the same light as a machine or instrument of trade which facilitates and abridges labor, and which, though it costs a certain expence, repays that expence with a profit.[200]

The importance of human capital may be illustrated by a contrast between two societies. In one of them, almost all physical capital is destroyed in a war. But there is a lot of human capital in this society so it would only take one or two decades to rebuild the country. In another society, considerable physical capital is intact when new rulers, possessing little human capital, take over. It would only take one or two decade to ruin the country. Germany in 1945 might serve as example of the first kind, and Zimbabwe in 1980 of the second kind.

The accumulation of human capital, for example learning to read and write and then to acquire skills, has benefitted the working class just as much, if not more, than those higher up in the social hiearchy. Piketty's decision to exclude human capital from the concept of capital he uses in his book therefore seems odd and arbitrary. The main reason he gives, that human capital is not marketable, is clearly wrong.[201] Even if it is not strictly speaking transferable between persons in the way physical assets are, it is certainly marketable: People with superior skills, talents and expertise and in better health earn more than others. As Adam Smith pointed out, this is the reason they

197 John Kay, *Other People's Money: Masters of the Universe or Servants of the People* (London: Profile Books, 2015).

198 Gissurarson, *Lessons for Europe from the 2008 Icelandic Bank Collapse* (Brussels: New Direction, 2017).

199 Claudia Goldin, Human Capital, *Handbook of Cliometrics,* ed. by C. Diebolt and M. Haupert (Berlin: Springer-Verlag, 2016), pp. 55–86.

200 Smith, *Wealth of Nations,* Bk. II, Ch. I, p. 282.

201 Piketty, *Capital,* p. 58.

invest in human capital, or "improved dexterity". But of course ownership of human capital is much more widely dispersed than ownership of physical capital, so Piketty's narrative about an endless inegalitarian spiral would seem less plausible if human capital was included.

If Piketty were worried about poverty rather than wealth, then it would be relevant that poverty is being rapidly reduced worldwide and that in affluent Western countries the living standards of all, including low-income groups, have vastly improved. According to a 2018 World Bank report, in 1990 more than a third of the world's population lived in extreme poverty. A quarter of a century later, in 2015, more than one billion people had escaped this condition. In 2015, approximately one-tenth of people on earth lived in extreme poverty. It was the lowest poverty rate in recorded history. The World Bank's announced target is to reduce extreme poverty to less than 3 per cent of the world's population by 2030. In 2015 more than half of the countries surveyed already had less than 3 per cent of their populations under that level. Tens of millions of people have escaped poverty every year since 1990, despite slow global growth in some years. Much of the progress has been in Asia, whereas Sub-Saharan Africa still remains desperately poor.[202] As a result of economic liberalisation, hundreds of millions in China and India have migrated into the middle class. According to Piketty's own figures, in his database, the real income of ordinary Chinese, the bottom 90 per cent of the population, on average almost tripled in the period from 1986 to 2002. This is an astonishing success, even if the top 10 per cent—the ruling communists and their cronies—may have seen their income increase more rapidly.

Moreover, mainland China is not the only Chinese country in the world. Three other Chinese economies, in Singapore, Hong Kong and Taiwan, have grown much more rapidly and are now as prosperous as many affluent Western countries. In 2017 GDP per capita was S57,700 in Singapore, $46,200 in Hong Kong, $624,300 in Taiwan, and only $8,800 in China.[203] This has been achieved peacefully, whereas in mainland China the 1949 communist victory over the nationalists led to a veritable bloodbath, mass executions and the imprisonment in labour camps of almost all surviving potential or imagined opponents of the new regime, followed by the unbelievable starvation to death of 44 million people in Mao's Great Famine of 1958–1962 and the massive destruction of people and property, including irreplaceable cultural artifacts, in the 'Cultural Revolution' of 1966–1976.[204] Piketty of course rejects central economic planning and totalitarianism, but he cannot disregard the evidence provided by socialist experiments all around the world, from mainland China and North Korea to Allende's Chile and Castro's Cuba, not to forget 'Bolivarian socialism' in Venezuela.

Income aggregates may sometimes obscure the fact how much easier life has become for all, also low-income groups, as measured in the ability to consume. Piketty notes than in nineteenth century Europe "a truly comfortable life required the possession of a large fortune."[205] This is no longer the case. It only requires the income of an unskilled worker in the United States. Middle-income and even low-income people in the United States and other affluent Western countries have access to goods and services that even the very rich could not get a century ago, like antibiotics, recorded music, adequate dental care and vision correction surgery. Things that only high-income people could afford seventy-five years ago, such as overnight package delivery, hour-long transcontinental phone calls and air-conditioned homes, are now available to all at reasonable prices.[206] "Travel was also expensive. It required horses, carriages, servants to take care of them, feed for the animals, and so on," Piketty writes. In late 2018, however, a return ticket on an aeroplane between London and Paris would cost around $100, whereas it would probably cost you around $20,000 in total, including airfare, food and accommodation, to travel around the world for a year.

Most importantly, as the poet said, "Time is the coin of your life. It is the only coin you have, and only you can determine how it will be spent."[207] It requires much less time now than before to earn the amount of money necessary to buy the necessities as well as luxuries of life. It would take an unskilled worker about 8–10 hours to work for the ticket on the aeroplane from London to Paris. Even if it might be difficult for him to save enough for the $20,000 trip around the world, nevertheless it would only be half of his annual income.[208] One clear and simple example from my native Iceland is a book. In the mid-1200s, the production of just a copy of an Icelandic saga would have cost the equivalent of at least $10,000 in modern money: Calves had to be reared and slaughtered to provide the parchment on which it would be written; berries had to be collected out of which to make the ink; a scribe had to be employed, or at least fed, clothed and lodged, to make the copy.[209] Now it requires only a little more than an hour for an ordinary Icelander to earn enough money to buy an 848 pages paperback containing most of the sagas.[210] Except for the three bright summer months in Iceland, in the thirteenth century the book produced at this great cost would have to be read by candlelight, and candles also are not costless. It has been estimated that the artificial light you could get in exchange for an hour of work at the average wage was around 186 lumen-hours in the mid-1200s, and 8.4 million lumen-hours in 2018.[211]

Not only has life become easier for all income groups: it has become much longer. In 1751, life expectancy at birth in Sweden was only 38 years. Many children died in their first year of life. In 2016, it had increased to 82 years. In Iceland, long a very poor country, life expectancy at birth was 33 years in 1838. It had become 82 years in 2016. The corresponding figures for the United States are 61 years in 1933 and 79 years in 2016.[212] The different life spans of different individuals and groups created perhaps the greatest inequality of all in the past: between the survivors and the dead. Certainly the rich suffered the consequences of inadequate health care: Queen Anne of Great Britain had several stillborn babies, suffered many miscarriages and saw her only two daughters who survived for more than a few months both die of smallpox in 1687. But better health in general, largely due to better houses and sufficient food, and improvements in health care have benefitted the poor much more than the rich and thus reduced one kind of inequality. Another important equalising factor in modern times has been the spread and distribution of education. In 1950, roughly half of the world's adults had never been exposed to any schooling. In 2010, despite rapid population growth in the preceding sixty years, completely unschooled people were only one-seventh of the world's adult population.[213]

People untainted by envy do not regard it as a serious problem that as the poor have become richer, the rich have also become richer. Piketty on the other hand frequently reveals his hostility towards the rich. He mentions the film *Titanic* twice, asserting that the director, James Cameron, was depicting the social structure of the United States in 1912, making wealthy Americans look just as arrogant as their European counterparts, "for instance, the detestable Hockley, who wants to bring young Rose to Philadelphia in order to marry her."[214] Noting that in 1912 capital was distributed more equally in the United States than in France or Britain, Piketty comments that nevertheless "the dreadful Hockley who sailed in luxury on *Titanic* in 1912 could have existed in real life and not just in the imagination of James Cameron."[215] But would the set-up on an American luxury steamship really be a good reflection of the structure of American society? To be sure, the passengers would travel on different classes. But they would have paid for it. An argument that they did not deserve their different positions on

202 *Poverty and Shared Prosperity 2018: Piecing Together the Poverty Puzzle* (Washington DC: World Bank, 2018).

203 World Bank. GDP per capita, current US$ (online), except estimate for Taiwan, from the Directorate-General of Budget, Accounting and Statistics, Executive Yuan, and the IMF.

204 Frank Dikötter, *The Tragedy of Liberation: A History of the Communist Revolution 1945–1957* (London: Bloomsbury, 2013); *Mao's Great Famine: The History of China's Most Devastating Catastrophe, 1958–*62 (London: Bloomsbury, 2010); *The Cultural Revolution: A People's History, 1962–1976* (London: Bloomsbury, 2016).

205 Piketty, *Capital,* p. 519.

206 Donald Boudreax, Get Real: A Review of Thomas Piketty's Capital in the 21st Century, *Anti-Piketty,* pp. 185–192.

207 Carl Sandburg, in a speech at his 85th birthday party 6 January 1963. Ralph McGill, *The Best of Ralph McGill: Selected Columns* (Atlanta GA: Cherokee Publishing, 1980), p. 82.

208 The assumption here is that the worker has $15 per hour and $45,000 per year, and that his government receipts and outlays would roughly even out.

209 Apparently, a famous Icelandic manuscript, Flateyjarbok, cost 113 calves. Sigurdur Nordal, Time and Vellum, *Annual Bulletin of the Modern Humanities Research Association,* Vol. 24 (1952), 15–26.

210 In late 2018, on amazon.com *The Sagas of the Icelanders* (London: Penguin, 2005) costs $20.94 in paperback and $20.89 on Kindle.

211 Matt Ridley, *The Rational Optimist* (London: Fourth Estate, 2010), p. 20.

212 *Human Mortality Database,* Max Planck Institute for Demographic Research

and University of California, Berkeley and INED, Paris. https://www.mortality.org

213 Nicholas Eberstadt, Longevity, Education, and the Huge New Worldwide Increases in Equality, *Anti-Piketty,* pp. 19–28.

214 Piketty, *Capital*, p. 189.

215 Ibid., p. 367.

In his polemic against the rich, Piketty invokes fictional characters from the film Titanic. But in real life positions are not fixed as is the case on a passenger liner.

the ship would therefore be unpersuasive. Nobody forced the third-class passengers to buy their tickets, which were probably much cheaper because of the first-class passengers.

Also, as Piketty mentions only in passing, "the dreadful Hockley" was not a real person, but the invention of the director. Some very wealthy real persons were however passengers on the *Titanic*, including mining heir Benjamin Guggenheim and businessman John Jacob Astor IV, the richest man on board. Both Guggenheim and Astor refused to get in the lifeboats until all women and children, also those from the third class cabin, had got there, and both perished. Ida and Isidor Strauss, the rich owners of Macy's, were also passengers. Ida refused to leave her husband, preferring to die in his arms. On the other hand, crewman George Symons who was in charge of a lifeboat which could hold 40 people, loaded it with six fellow crewmen and five passengers from First Class, three of them male, then launching the boat. "Money, it seems, doesn't tell you everything about a man," American journalist Jonah Goldberg drily comments in his review of Piketty's book.[216]

These are not trivial points. A crucial distinction between a ship and a society is that on the ship positions are fixed: if you travel third class, you stay third class throughout the journey, whereas in a free market order you may move upwards, or downwards. Piketty is concerned about those who travel first class in life, as he sees it. He mentions the *Forbes* list of billionaires, arguing that it shows that in 1987–2010 their wealth grew at a real average rate of 6.8 per cent, or three times the annual growth of the world economy of 2.1 per cent. But he ignores the fact that these were *different* people: the individuals on the list had moved, upwards and downwards, some maintaining their wealth, invariably at a lower rate than Piketty envisaged, other losing most or all of it.

It is instructive to go through *Forbes'* original 1987 list of billionaires in the world. The four frontrunners were all Japanese. Number one was Yoshiaki Tsutsumi who had an estimated fortune of $20 billion. Last time he appeared on the list was in 2006 when his wealth had shrunk to $1.2 billion, or $678 million in 1987 dollars. Thus, it had dropped by 96 per cent in 19 years. Number two was Taikichiro Mori with a fortune of $15 billion. He died in 1993, and in 2015 the combined worth of his two sons and heirs was $6.3 billion, or $3 billion in 1987 dollars. Thus, his wealth had shrunk by 80 per cent. Number three and four were also Japanese real estate moguls, Shigeru Kobayashi and Haruhiko Yoshimoto, with fortunes of $7.5 billion and $7billion, respectively. They have disappeared from the list, so they have probably fared even worse than Tsutsumi and Mori. Number five was Saudi businessman Salim Ahmen Bin Mahfouz, with a fortune of $6.2 billion. In 2009, his heir died and left a fortune of $3.2 billion, or $1.7 billion in 1987 dollars, a decrease of 73 per cent."A sudden fortune will dwindle away," as it says in the Proverbs.[217]

Number six on the 1987 Forbes list were Swedish businessmen Hans and Gad Rausing, with a combined fortune of $6 billion. Today, Hans Rausing's wealth is estimated to be $12 billion, whereas Gad Rausing left $13 billion when he passed away in 2000. Accounting for inflation, their wealth grew in 1987–2015 from 6 to 12 billion dollars, which means that it grew at an annual rate of return of 2.7 per cent, far less than Piketty's 6.8 per cent. Number seven were three Hungarian-Canadian property developers, the Reichmann brothers, with an estimated wealth of $6 billion. Later, they went bankrupt and saw their wealth go down to $100 million. One of the brothers bounced back however and was in 2015 worth $2 billion, or $975 million in 1987 dollars. This would nevertheless amount to a loss of 84 per cent. Number eight was Yohachiro Iwasaki, with a fortune of $5.6 billion. His heir died in 2012 with assets of $5.7 billion, equal to $2.8 billion in 1987 dollars, a 50 per cent decrease in assets. Number nine was Canadian businessman Kenneth Ray Thomson, with a fortune of $5.4 billion. He was more successful than some others on the list. When he died in 2006, he had increased his total wealth to $17.9 billion, or $9.3 billion in 1987 dollars. However, the annual rate of return for his capital was 2.9 per cent, not the 6.8 per cent envisaged by Piketty. Number ten was Japanese businessman Keizo Saji, with a fortune of $4 billion. He died in 1999 with a fortune of $6.7 billion, or $4.6 billion in 1987 dollars. So, his annual rate of return was 1.1 per cent.[218]

It is no less instructive to go through the most recent *Forbes'* list of billionaires, in 2018. In 2018, the magazine found 2,208 billionaires in the world, with a total wealth of $9.1 trillion, of which the 20 richest people listed controls 13 per cent.[219] Seven of the ten frontrunners are American. Number one is Jeff Bezos, founder of Amazon, with an estimated fortune of $112 billion. Number two is Bill Gates, founder of Microsoft, worth $90 billion. Number three is investor Warren Buffet, worth $84 billion. Number four is French entrepreneur Bernard Arnault, who sells luxury goods. He is worth $72 billion. Number five is Mark Zuckerberg, creator of Facebook, worth $71 billion. Number six is Spanish entrepreneur and retailer Amancio Ortega, whose holdings include the Zara chain of shops. He is worth $70 billion. Number seven is Mexican businessman Carlos Slim, worth $67.1 billion. Only a few years earlier he had been reputed to be the world's richest man. Already wealthy when he was able to buy the Mexican telecom company from government, then Slim became super-rich. Number 8 and 9, with a tie, are Charles and David Koch, each with a fortune of $60 billion. Number ten is Larry Ellison, the founder of technology firm Oracle, worth $58.5 billion. All ten billionaires are entrepreneurs. Four of them, Bezos, Gates, Ortega and Ellison, come from humble origins, while two, Buffet and Zuckerberg, are from middle-class families. Four of them come from affluent or even wealthy families, Arnault, Slim and the Koch brothers, but they made the bulk of their fortunes themselves.

Over time, there has been a remarkable change in the composition of billionaires on the *Forbes'* list. It is a change which goes directly against what could be expected from reading Piketty's warnings against patrimonial capitalism. In 1984, *Forbes* published a list not of billionaires solely, but of the 400 richest people in the world. Then, less than half the people on the list were self-made. In 2018, by contrast, 67 per cent, two-thirds, of the 400 richest people in the world created their own fortunes.

> Over the past 30-plus years, the number of Forbes 400 members who have forged their own path, using entrepreneurial capitalism as a means to attain a vast fortune, has increased dramatically. This tells us many things, but one should stand taller than the rest: The American Dream, it seems, is alive and well.[220]

216 Jonah Goldberg, Mr. Piketty's Big Book of Marxiness, *Commentary* (July, 2014). https://www.commentarymagazine.com/articles/mr-pikettys-big-book-of-marxiness/

217 Proverbs, 13:11.

218 Juan Ramón Rallo, Where are the 'Super-Rich' of 1987, *Anti-Piketty,* pp. 31–35.

219 Kerry A. Dolan and Louisa Kroll, Forbes Billionaires 2018: Meet the Richest People on the Planet, *Forbes* 6 March 2018.

220 Louisa Kroll, The Forbes 400 Self-Made Score: From Silver Spooners to Bootstrappers, *Forbes* 3 October 2018.

A similar result was obtained by the *Sunday Times* in London when its journalists compiled a list of the 1,000 richest people in the United Kingdom in 2018.

> Britain has been transformed into a country where the self-made can succeed, with almost all the 1,000 richest people now entrepreneurs who built their own fortunes. Inherited wealth and old money have been all but banished from the 30th annual Sunday Times Rich List. When the Rich List was first published in 1989 just 43% of the entries had made their money themselves and the surest way to a fortune was to be a landowner — preferably with a title. Today 94% of those in the Rich List are self-made entrepreneurs behind some of Britain's game-changing businesses.[221]

The richest man on the list, Jim Ratcliffe, with an estimated fortune of £21 billion, lived in council houses near Manchester as a child, was sacked from his first job after three days and only started a business when he was nearly 40. The picture of the rich in 2018 found in *Forbes* and *Sunday Times* is quite different from that presented by Piketty where wealth is the result of capital accumulation, with the past tending to devour the future.

In real life, ordinary people are not stuck in a third class cabin on a ship. They can go from rags to riches, and the other way around: Even film director James Cameron let his invented millionaire scoundrel, "the dreadful Hockley," lose all his wealth in the Great Depression and subsequently commit suicide. But why does Piketty want to bring down the rich? Why does he want to confiscate their wealth? Leaving sheer envy aside, Piketty's answer probably is summed up in his statement, already noted, that "capitalism automatically generates arbitrary and unsustainable inequalities that radically undermine the meritocratic values on which democratic societies are based." Is this plausible? First, many non-socialists would certainly agree to a political programme of reducing inequalities generated by government, which would include revising statutes on tariffs, quotas, immigration restrictions, occupational licensing, patents, copyrights, trademarks, agricultural subsidies, and other government subsidies. Second, it is difficult to see why a society with large inequalities should therefore be unsustainable. There is more inequality in the United States than in France, but also more political stability. Many governments in less developed countries are unstable, but that is more because of poverty than inequality. Third, Piketty is right that the distribution of income and wealth in a free society is to some extent arbitrary and certainly not according to merit. But as I pointed out in the analysis of Rawls' theory of justice, this distribution should be seen as the unintended consequence of a myriad of market transactions. If this distribution is reached without unjust behaviour such as theft or fraud, then there is no cause for complaint: Then distribution is not unjust, which may mean that we can consider it as being just.

The arguments against the rich from unsustainability and moral merit are not very plausible. But Piketty also seems to believe that a great concentration of wealth threatens democracy. He may be partly right. Certainly, the Rothschilds and the Rockefellers are in a better position than you and I to influence judges, policemen, politicians, bureaucrats and journalists as well as the general public. Even in countries which nominally guarantee equality before the law, people have vastly different resources when confronted by the law. Jonathan Swift may not have been altogether wrong: "Laws are like cobwebs, which may catch small flies, but let wasps and hornets break through." Piketty's compatriot and fellow socialist, novelist and Nobel Laureate Anatole France ironically referred to "the majestic equality of the laws, which forbid rich and poor alike to sleep under the bridges, to beg in the streets, and to steal their bread."[222] The argument from inequality of resources may have special cogency in small places. A dramatic example is invented by Swiss playwright Friedrich Dürrenmatt. In *The Visit*, he describes how the struggling townsmen of Güllen hope for a big donation from a rich old lady, Mrs. Zachanassian, who returns to her home town after many years. (Her name is a composite of the names of three notorious European tycoons, Zacharoff, Onassis and Gulbenkian.) She holds a grudge against one of them, and the other townsmen agree to kill him at the request of the lady. The murder is hushed up, the donation is made, and the old lady leaves with the body in a casket.[223]

221 Robert Watts, The Rich List: At last, the self-made triumph over old money, *Sunday Times* 13 May 2018.

222 Anatole France, *Le lys rouge* (Paris: Calmann Lévy, 1894), ch. 7. *The Red Lily* (Doylestown PA: Wildside Press, 2007), p. 75.

223 Friedrich Dürrenmatt, *Der Besuch der alten Dame* (Zürich: Arche, 1956).

Money talks. While Iceland is not like a Swiss village, she is a tiny country. In 2002–2008 she saw a retail magnate, Jon Asgeir Johannesson, who had made a lot of money on investments abroad buy up all the private media and use them in a political vendetta against Prime Minister David Oddsson, Leader of Iceland's conservative-liberal Independence Party, blaming him for a police investigation of Johannesson's business activities.[224] While the retail magnate did not succeed in driving Oddsson out of office, he may have damaged his reputation.[225] Although Johannesson was eventually convicted for some illegal activities, he had spent a fortune on a forceful defence, with many feeling that Icelandic judges had showed surprising leniency in his case.[226] Rich people have power. I should know. In 2004, to my great surprise, a wealthy Icelandic businessman who had then recently moved from Reykjavik to London dragged me before an English court, accusing me of libel because of some unflattering remarks I had made about him in English at an international conference in Iceland in 1999. Even if he did not succeed in obtaining a libel judgement against me, the whole affair cost me about $250,000, small beer for him, but a lot of money for a university professor.[227]

In a larger society, however, if we worry about possible abuse of economic power, it seems misguided to transfer it from thousands of millionaires and billionaires to the state, controlled by a few politicians and bureaucrats. It is much more reasonable to try and increase the number of the rich and thus to encourage further dispersal of economic power. Implicit in Piketty' argument is the illusion that the rich are a unified force, wanting to control the whole ship from their first class cabin. In fact they are different people with different and often conflicting interests and ideas, and their power to mould public opinion by spending money may be over-estimated. In the 1930s, the Nazis in Germany did not receive crucial support from the financial community, contrary to common belief.[228] In mid-twentieth century, it did not prevent Scandinavian social democrats from taking power that the press was overwhelmingly hostile to them. In the United States today, many rich people support left-wing causes, for example billionaire investor George Soros and media magnate Michael Bloomberg. Jeff Bezos owns *Washington Post*, while Carlos Slim is the largest single shareholder in *New York Times*, both newspapers usually being seen as sympathetic to the left. The Koch brothers are libertarians fighting against the establishment that they see embodied in the existing political parties. While Presidents John F. Kennedy and Donald Trump were rich, Richard M. Nixon and Barack Obama came from modest backgrounds. Moreover, perhaps some of the rich perceive their political activities to be defensive rather than offensive: they are after all easy targets for demagogues. They may want not to control society, but simply to keep their money.

Hungarian actress Zsa Zsa Gabor once quipped that no rich man was ugly. Piketty seems on the other hand to find all rich men obnoxious. Be that as it may, in any account of possible disadvantages from having the rich around, we should also note the advantages, some of which may not be immediately obvious. Two such advantages have already been mentioned: one is Adam Smith's observation that they will buy goods or services from the non-rich and thus improve their condition; the other is that they are the source of capital for diverse experiments and thus for innovation and economic growth. Two further benefits should be noted. One is that the rich lower the cost of experimentation with consumer goods. Unwittingly perhaps, they are the guinea pigs of the free market. Goods which are initially produced as luxuries for the rich, eventually become accessible to the rest of society in an experimental process. Examples are the motor car, an aeroplane ticket, air conditioning, the personal computer, and a cellular phone. Under capitalism, entrepreneurs are eager to find ways of producing more cheaply for the masses what the rich already can afford. Yet another advantage of having rich people around is that they have more resources than others to challenge the abuse of power. It is not only Josef K. in Kafka's *Trial* who may find himself up against a remote, unaccountable authority. One of

224 Gissurarson, *Lessons for Europe*, pp. 14 and 18.

225 Gissurarson, Anti-Liberal Narratives About Iceland, 1991–2017, *Econ Journal Watch*, Vol. 14, No. 3, pp. 362–398.

226 Bjorn Bjarnason, *Rosabaugur yfir Islandi* [Iceland in Baugur's Shadow] (Reykjavik: Ugla, 2011); Oli Bjorn Karason, *Sidasta vornin* [The Ultimate Defence] (Reykjavik: Ugla, 2012). Bjarnason was Justice Minister in 2003–2009. Karason is a journalist and Member of Parliament for the Independence Party.

227 Sarah Lyall, Britain, Long a Libel Mecca, Reviews Laws, *New York Times* 10 December 2009. https://www.nytimes.com/2009/12/11/world/europe/11libel.html

228 Henry Ashby Turner, *German Big Business and the Rise of Hitler* (New York: Oxford University Press, 1985).

my teachers at Oxford, John R. Lucas, called this the 'Heathrow explosives argument'. When the luggage handlers at Heathrow know that one of hundred suitcases going through will explode if carelessly handled, but do not know which one it is, they will treat all hundred suitcases much more carefully than they would otherwise do.

Probably we see these four advantages of having the rich around most clearly by asking if a person motivated by self-interest (as people are under Rawls' veil of ignorance) would prefer a large group of dirt-poor immigrants to an equally large group of very rich settlers, bringing with them ample human or physical capital. This does not mean that the rich are benevolent: it is probably not always a part of their intention to serve the non-poor. Henry Ford was a Nazi sympathiser, but his Model T was an affordable car and he paid his workers higher wages than they would get elsewhere. Neither does this mean that we should applaud people for being rich: even if they may be socially useful, it makes them morally no better and no worse. The difference between us and the rich, as Ernest Hemingway observed, is simply that they have more money.[229]

In 2018, the poor are fewer than ever before, and low-income groups are faring better, while a higher proportion of the rich, not least the super-rich, is self-made. But these three facts, even if highly relevant, do not refute Piketty's main contention, that inequality of income and wealth has increased considerably in the thirty or forty years preceding the 2014 publication of his book. Many were impressed by the wealth of data he presented to back up this contention: "Compared to previous works, one reason why this book stands out is that I have made an effort to collect as complete and consistent a set of historical sources as possible in order to study the dynamics of income and wealth distribution over the long run."[230] Nevertheless, it should be recalled, and indeed stressed, that global inequality of income, as traditionally measured, has in fact decreased. The global Gini coefficient of income inequality, a widely-used if imperfect measurement of inequality, was 66.9 in 1988 and has gone down to 57.3 in 2015.[231] Piketty's claim can only be that inequality of income and wealth has increased in developed countries, Western democracies such as the United States, Canada, and the member states of the European Union.

A woman mad with envy by Theodore Gericault. Should envy be regarded as a legitimate personal preference?

Piketty's data on inequality in the Western world may also be flawed. First, it seems that the increased inequality of wealth identified by Piketty as a worldwide trend in the last thirty or forty years is not caused by any runaway accumulation of capital by the rich, but rather by a surge in real estate prices. This property bubble was caused mainly by public policies, at the state level by artificially low interest rates and at the local level by strict zoning laws reducing the supply of land. The bubble mostly benefitted the middle class, neither low-income or high-income groups: It was reflected in prices of real estate being exchanged or in its registered value, not in the rate of return from housing capital for rent which seems to be no higher today than it was in the 1950s in the countries for which data are available: France, the United States, the United Kingdom, Canada and Germany.[232] American economist Richard Sutch has gone carefully over Piketty's data on wealth distribution in the United States over time and found them to be unreliable, especially about the period before 1970.[233] There are also problems with the data Piketty used about wealth in the United Kingdom and Sweden: he sometimes seems to have picked data points arbitrarily, or even worse consistently, to reinforce his narrative about capital tending to grow faster than the economy at large.[234] Moreover, it should be noted since Piketty has a lot to say about nineteenth century Britain that according to one study, the plurality of the rich in Victorian Britain earned their fortunes in commerce and finance, especially in the City of London, rather than in manufacturing and industry. This study was largely based on a detailed analysis of the probate records of wealth at death, as well as income tax and other objective sources.[235]

Second, it also seems that the increased inequality of income identified by Piketty as a worldwide trend is not mainly caused by dividends from a rapidly growing capital of the rich: In the case of the United States, it may to some extent be a statistical illusion, as Harvard economist Martin Feldstein argues. Piketty does not take into account important changes in taxation, implemented in the 1980s. In 1981, the top tax rate on interest, dividends and other investment income was reduced from 70 to 50 per cent. This created an incentive to switch assets from low-yielding tax-free investments like municipal bonds to higher yielding taxable investments. Even if there may not have been any increase in real inequality, the data would show such an increase. In 1986, the top tax rate on all income was reduced from 50 to 28 per cent. This not only reinforced the incentive to switch to high-yielding taxable investments: it also encouraged high-income people to work longer hours and to take more of their income as taxable salary, not not as fringe benefits and deferred compensation. Again, even if there may not have been any increase in real inequality, the data would show such an increase. Moreover, Piketty's data excludes the value of transfer payments such as social security, health care benefits and food stamps that form a significant part of the personal income of low-income groups in the United States. "The problem with the distribution of income in this country is not that some people earn high income because of skill, training, or luck," Feldstein observes. "The problem is the persistence of poverty. To reduce this persistent poverty we need stronger economic growth and a different approach to education and training, not the confiscatory taxes on income and wealth that Piketty recommends."[236]

To some extent the increased inequality of income identified by Piketty as a worldwide trend in the last thirty or forty years may however be real. One obvious explanation for it is derived from the fact that some people possess special non-reproducible skills. If the demand for soap increases, then under normal circumstances the price will rise and the supply consequently increase. But you cannot increase the supply of some goods, including special individual skills and talents. There is only one Enrico Caruso or Fyodor Chaliapin, or more currently, only one Madonna or Oprah Winfrey, Wilt Chamberlain or Tiger Woods. Also, Steve Jobs of Apple and Bill Gates of Microsoft had some qualities others lacked, however hard those others tried. When Jobs returned to his old company in 1997 after twelve years elsewhere it was on the verge of bankruptcy. He turned it around. If you own a good which comes only in fixed supply while the demand for it increases, then you can capture rent from selling it (which was Henry George's old argument against landowners). What happened through globalisation—an extension of the markets for goods or services from, say, one billion people to perhaps five or six billion—was that people possessing special skills could collect much more rent than before. With the caveat that the legislator should not help these extraordinary individuals to capture monopoly rent through strict copyrights, sports subsidies, patents or suchlike, I see nothing wrong with them deriving huge benefits from selling

229 Ernest Hemingway, The Snows of Kilimanjaro, *Esquire,* Vol. 27, No. 6 (August 1936), p. 200.

230 Piketty, *Capital,* p. 26.

231 Frederick Solt, The Standardized World Income Inequality Database, *Social Science Quarterly,* Vol. 97, No. 5 (2016), pp. 1267–1281. Zsolt Darvas, Blog Post 19 April 2018, http://bruegel.org/2018/04/global-income-inequality-is-declining-largely-thanks-to-china-and-india/

232 Henri Lepage, Is Housing Capital? *Anti-Piketty,* pp. 81–84.

233 Richard Sutch, The One Percent across Two Centuries: A Replication of Thomas Piketty's Data on the Concentration of Wealth in the United States, *Social Science History,* Vol. 41 (2017), pp. 587–613.

234 Chris Giles, The Financial Times vs. Piketty, *Anti-Piketty,* pp. 93–96; Malin Sahlén and Salim Furth, Piketty is Misleading about the Swedish Case, *Anti-Piketty,* pp. 97–100.

235 William D. Rubinstein, *Men of Property: The Very Wealthy in Britain Since the Industrial Revolution* (London: IEA Social Affairs Unit, 2006).

236 Martin Feldstein, Piketty's Numbers Don't Add Up, *Anti-Piketty,* pp. 73–76. Quotation on p. 76.

their special skills. They are enriching our lives, not doing anyone down. Even if Mozart may have reduced Salieri's self-esteem, the rest of us is vastly better off having access to his compositions.

In modern culture, Salieri serves as the epitome of envy. But perhaps it is too unkind an interpretation of Piketty's hostility towards the rich to say that it is driven by envy. It would be more appropriate to regard it as being motivated by rivalry. Piketty comes from a long tradition of French intellectuals who support a strong state dominated by themselves, graduates of elite schools advising left-wing politicians. These intellectuals consider the rich a competing elite, at best obnoxious, at worst dangerous. They are the heirs of the failed French Revolution, thinking of themselves as representatives of Rousseau's 'General Will' (*volonté générale*), agreeing with him that

> The first man who, having enclosed a piece of ground, bethought himself of saying *This is mine*, and found people simple enough to believe him, was the real founder of civil society. From how many crimes, wars and murders, from how many horrors and misfortunes might not any one have saved mankind, by pulling up the stakes, or filling up the ditch, and crying to his fellows, "Beware of listening to this impostor; you are undone if you once forget that the fruits of the earth belong to us all, and the earth itself to nobody."[237]

As Alexis de Tocqueville saw clearly, the French Revolution was a culmination of a centralising process that had been going on in France for centuries, from Colbert the tax collector to Robespierre the self-proclaimed agent of the General Will.[238] Piketty may be regarded as a modern day Jacobin, yearning back to the heady days of 1789, when he would have taken a seat on the left in the National Assembly and voted for confiscatory taxes on the land-owning nobility as well as on rich merchants.

There was however another strong French tradition which emphasised gains from trade and gradual reform instead of a revolution. Voltaire who wrote with the same perception about the English as de Tocqueville about the Americans commented:

> However, I need not say which is most useful to a nation; a lord, powdered in the tip of the mode, who knows exactly at what o'clock the king rises and goes to bed, and who gives himself airs of grandeur and state, at the same time that he is acting the slave in the ante-chamber of a prime minister; or a merchant, who enriches his country, despatches orders from his counting-house to Surat and Grand Cairo, and contributes to the felicity of the world.[239]

Other eminent representatives of this conservative-liberal French tradition include Benjamin Constant who offered a cogent critique of Rousseau,[240] Frédéric Bastiat who tried to make the invisible hand visible,[241] and of course de Tocqueville.

237 Jean Jacques Rousseau, *Discours sur l'origine et les fondements de l'inégalité parmi les hommes* (Amsterdam: March Michel Rey, 1755), Pt. II, beginning words.

238 Alexis de Tocqueville, *L'Ancien régime et la révolution* (Paris: Michel Lévy, 1866).

239 Voltaire [François-Marie Arouet], *Lettres sur les Anglois* (Basle [Basel]: 1734), §10, Sur la commerce. Surat used to be a large seaport in the Indian Mughal Empire.

240 Benjamin Constant, De la liberté des Anciens comparée à celle des Modernes, lecture in Paris 1819. Repr. in *Ecrits politiques* (Paris: Gallimard, 1997), pp. 589–619.

241 Frédéric Bastiat, *Pétition des fabricants de chandelles* (1845) and *La Loi* (1850), both repr. in *Œuvres complètes*, Vol. IV (Paris: Guillaumin, 1853); *Ce qu'on voit et ce qu'on ne voit pas* (1850), repr. in *Œuvres complètes*, Vol. V (Paris: Guillaumin, 1854).

9

A DIGRESSION ON BALZAC AND AUSTEN

According to Thomas Piketty, "the novels of Jane Austen and Honoré de Balzac paint striking portraits of the distribution of wealth in Britain and France between 1790 and 1830." They "depicted the effects of inequality with a verisimiliture and evocative power that no statistical or theoretical analysis can match."[242] Piketty warns his readers that if confiscatory taxes are not imposed on the income and wealth of the rich, they would accumulate capital on such a scale that finally we would find ourselves in a society not too different from that described by Austen and Balzac. Piketty is of course right that in early nineteenth century Britain and France were societies of much greater inequality than modern Western society, unlike the United States at the same time, a much better example of what some would call unbridled capitalism. But in his literary exegesis, Piketty seems to be mistaken. What the novels of Austen and Balzac illustrate is not the tendency of capital to be accumulated under some inexorable laws, but rather its precariousness. They are not about capital; they are about the lack of it.

In his novels, Honoré de Balzac described the precarious nature of wealth: personal passions led to the dissipation of capital.

The novel by Balzac invoked most frequently by Piketty is *Père Goriot*. It takes place in Paris in 1819–1821, mainly in a boarding house run by a Madame Vauquer, a miserly old widow. The residents are rather poor, but not desperately so, and they all appear respectable. But strong, even violent passions are lurking under the calm surface of the house, threatening to consume some of the boarders and destroy them. Eugène de Rastignac is a young and handsome student of law. He is from Angoulême in Southwestern France where his noble family struggles to make ends meet, as the income from their small estate is only 3,000 francs a year, whereas the cost of keeping the favourite son in university is 1,200 francs a year. Rastignac dreams of gaining entry into Parisian society and pursuing a glittering career, but he is constrained by his lack of money. Old Jean-Joachim Goriot is a former vermicelli-maker who lives very modestly, counting every penny. Occasionally the other residents see him in the company of either of two beautiful, expensively dressed young ladies. They first assume that these are his mistresses, but find out that they are in fact his daughters. Goriot had been a rich man, but he had used most of his wealth to provide dowries for his daughters who were therefore

242 Piketty, *Capital*, p. 2.

able to marry well. Delphine´s husband is the Baron de Nucingen, a rich banker, originally from Alsace. Anastasie and her husband, the Count de Restaud, are the social superiors of the de Nucingen couple. Goriot loves his daughters passionately. But his two sons-in-law look down on him and when they think they can wrest no more money out of him, they no longer invite him to their homes. The daughters only speak to their father when they need something.

Rastignac's and Goriot's paths cross unexpectedly outside the boarding house after Rastignac seeks out a rich relative in Paris, the Viscountess de Beauséant, who introduces him to the high society of which she is a prominent member. Rastignac meets Countess Anastasie de Restaud, who takes offence however when he mentions her father, old Goriot, his fellow lodger. Viscountess de Beauséant then suggests that instead he should try to seduce the other daughter, Baroness de Nucingen, who would very much like to be invited to receptions and balls given by the Viscountess. She gives her cousin Rastignac a lesson in the ways of the world: For twenty years old Goriot had given his whole heart to his daughters, and then, one day, he gave them all his fortune, too. "The lemon was squeezed, and the daughters flung the rind into the gutter."[243] She tells Rastignac that "The more cold-blooded your purpose the surer you will be of success. Strike without pity, and the world will fear you. Treat men and women as post-horses: never mind if you founder them, so long as they get you to the next relay."[244]

Two other residents at Madame Vauquer's boarding house come to play a role in Rastignac's life. Victorine Taillefer, a gentle and sweet girl, is the daughter of a rich businessman who refuses to recognise her, puts her on the meager allowance of 600 francs a year and plans on leaving his whole wealth to his only son, her brother. Victorine is attracted to Rastignac. This is noticed by the mysterious Vautrin who has taken a liking to Rastignac. Like Viscountess de Beauséant, he gives the young law student a lesson in the ways of the world, although Vautrin's advice is not to seduce Baroness de Nucingen, but to marry Victorine Taillefer. But first she has to be made an heiress. Vautrin offers to have her brother killed against a part of the wealth Rastignac would thus acquire. Piketty devotes a whole subsection in his book to the long speech Vautrin delivers in order to convince Rastignac of his plan:[245]

> If you have no one to push your fortunes, you will rot in your petty judgeship. When you are thirty you will be promoted to twelve hundred francs per annum, unless by that time you have flung your gown to the nettles. At forty you will marry a miller's daughter, with six thousand francs a year for her portion. To all this you say, Never! Well, if you have influence you may possibly at thirty get to be *procureur du roi* [prosecuting attorney], with five thousand francs a year, and marry the mayor's daughter.[246]

Vautrin also says:

> Do you know how to win a first place in the struggle? I will tell you. By the highest genius, or the lowest corruption. You must either find a way for yourself through the crowd like a cannon-ball, or you must creep through it silently like a pestilence. Honesty and uprightness won't help you. People bend beneath the power of genius, but they hate it. Genius is calumniated because it takes what it can get and never shares its takings; but the world bows before its strength. In other words, the world worships on its knees those whom it cannot smother in the mud. Corruption is also strength. Genius is rare. It follows that corruption is the resource of the great commonplace majority ; and you will find it everywhere.[247]

At the end of his speech Vautrin utters memorable words: "The secret of a great fortune made without apparent cause is soon forgotten, if the crime is committed in a respectable way."[248]

243 Honoré de Balzac, *Le Père Goriot* (Paris: Revue de Paris, 1834–1835). *Père Goriot* (Boston: Roberts Brothers, 1885). Many English translations are available online.

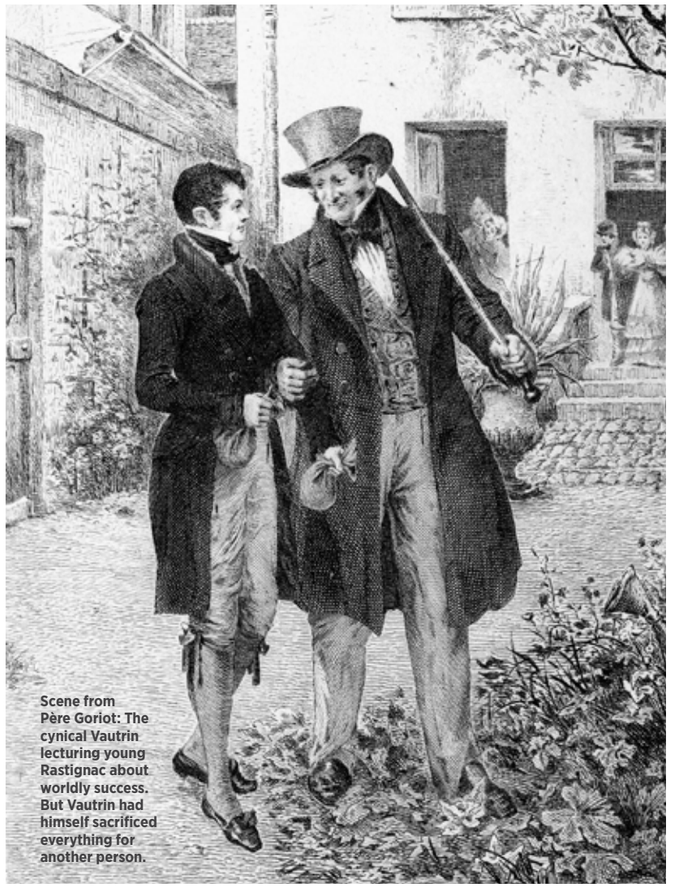
244 Balzac, *Père Goriot*, pp. 99–100.

245 Piketty, *Capital,* pp. 298–301.

246 Balzac, *Père Goriot*, p. 131.

247 Ibid., p. 134.

248 Ibid., p. 142.



Scene from Père Goriot: The cynical Vautrin lecturing young Rastignac about worldly success. But Vautrin had himself sacrificed everything for another person.

Rastignac indignantly refuses to take part in such a plot, but Vautrin does not take him seriously and has Victorine's brother killed. It turns out however that Vautrin is being watched by the police. His real name is Jacques Collin, and he is a hardened criminal who has escaped from prison, although he did not commit the first crime for which he was convicted. Collin, or Vautrin, a confirmed bachelor, had taken a fancy to a handsome young fellow who had committed a forgery, and he took his crime upon himself. Now Vautrin manages the financial affairs of convicts in several prisons. Having made sure that Vautrin is in fact Collin, the police apprehends him at the boarding house without knowing of his latest crime. As the other residents watch in shocked silence, Vautrin declares himself a disciple of Rousseau. "A convict of the stamp of Collin, here present, is a man who is less base than other men, and who protests against the glaring deceptions of the social contract, as Jean Jacques called it," he says. "I stand alone against the Government, with all its courts of law, its budgets and gendarmes, and I get the better of it."[249]

Meanwhile, Goriot's daughters get into difficulties. Anastasie's lover is a gambler who rakes up debt that she tries to pay, with the remnants of her father's money, but also by selling some heirlooms of the Restaud family. Finally, the lover absconds, leaving behind a staggering debt. Anastasie's husband finds out her theft and imposes strict rules on her. Delphine also wants to give her lover money, but she cannot get it from her husband, the baron, who has tied down her dowry in speculations. Rastignac's relative, Viscountess de Beauséant, suffers the indignity that her lover, a Portuguese nobleman, marries a rich heiress. Devastated, she decides to move to the countryside, but first she gives a ball at her house. Both the Goriot sisters are invited. Anastasie needs thousand francs to settle yet another debt before the ball. In a desperate attempt to help her, old Goriot sells his silver spoons and forks and a year's interest in his annuity. Deeply distressed, he suffers a stroke. The two sisters go to the ball while their father is dying. The next day they ignore Rastignac's pleas to visit old Goriot at his deathbed, and when finally Anastasie turns up, her father has just passed away. The sons-in-law both refuse to contribute to the cost of burying Goriot. Rastignac borrows money to pay for the funeral, and he and the handyman at the boarding house are the only mourners. After Goriot's coffin has been lowered into the grave, Rastignac goes to the highest point of the cemetary, looks out over Paris and exclaims: "War! war between us, henceforth!" In the evening he has a dinner appointment with Baroness de Nucingen.[250]

Unsurprisingly, *Père Goriot* is regarded as one of Balzac's finest novels. It is fast-paced, with one revelation after another, full of colourful characters about whom the reader is eager to find out more. But it would be misleading to say that it is a credible account of French society in the restoration years, after Napoleon's defeat and the return of the Bourbon kings, let alone of capitalism in general. With the exception of the rather insipid Victorine Taillefer, there is not a single decent person in the book. It

249 Ibid., p. 248.

250 Ibid., p. 348.

is really a story about the formation, or perhaps deformation, of Rastignac's character whereas the other persons remain more or less unchanged. He is slowly corrupted by Paris, becoming a cynic although he retains his generosity and good nature. When he, at the end, talks about war between himself and Paris, he means that he personally wants to succeed, but not that he is going to try and reform Parisian society, or to turn his back on it. It is noteworthy that both the persons who lecture Rastignac on success are failures themselves: Viscountess de Beauséant is defeated by a rich heiress in the contest for the Portuguese nobleman; and Vautrin, a rebel without a cause, a social outcast, is arrested. It should also be recalled that Balzac himself had dropped out of university, had failed in various business enterprises and was all his life in financial difficulties.

It is true that *Père Goriot* is largely about the depraving effects of money, or rather the lack of it. Indeed, long before Piketty Marx wrote approvingly about Balzac "who so thoroughly studied every shade of avarice" and "who is generally remarkable for his profound grasp of actual conditions".[251] But what is remarkable about Balzac's novel is how well it illustrates the precariousness of capital. Those who possess capital often squander it. Money may debase your character, but your passions may wipe out your money. The best example is old Goriot himself who had been a rich man, but had spent all his money on his ungrateful daughters. In his case passion overruled reason, as he bitterly admits on his deathbed. His daughters cannot control themselves, either. They spend far beyond their means, and Anastasie's lover, an arrogant nobleman, has lost enormous sums of money in gambling. Delphine's husband has all her money tied up in risky speculations which may or may not bring them an adequate return after a few years. Victorine Taillefer's father is rich, but he spitefully denies her any part in his wealth. Vautrin was also driven by passion when he took his friend's crime upon himself. He is certainly not a living proof that crime pays. His observation to Rastignac that "The secret of a great fortune made without apparent cause is soon forgotten, if the crime is committed in a respectable way," is the inspiration for Mario Puzo's pithier statement in his novel about the American mafia: "Behind every great fortune there is a crime."[252] But this hardly applies to capitalism in general. A mafia is an abomination, not a natural outgrowth of society. The rantings of madmen or criminals may occasionally offer some insights, but they should not be taken as serious social analyses.

Money may corrupt, but so does power. The difference is that power over other people can have much worse consequences for them than the lack of money. The usurer is unwelcome, but preferable to the executioner. Consider the characters in Balzac's novel. Probably not a single one of them could have been entrusted with power: Rastignac is an opportunist who becomes shameless over time; old Goriot is narrow-minded, and really a maniac; his daughters Anastasie and Delphine are frivolous and irresponsible; their husbands are cold-hearted and selfish; Madame Vauquer is a miser and Victorine a religious zealot. The only person in the novel who expresses a political opinion, in favour of Rousseau, Vautrin, is a criminal. It could be observed in the French Revolution starting thirty years before what happens when Rousseau's disciples get power and start to implement their ideas of the 'General Will' and Brotherhood. In early September 1792 revolutionary forces massacred more than one thousand political prisoners in Paris, and a mob killed Queen Marie Antoinette's faithful lady-in-waiting, the Princess de Lamballe, decapitated the corpse, put the head on a pike and paraded it through the steets of the French capital. During the reign of terror, in 1793–1794, not only was the guillotine working full time in Paris: thousands of people suspected of opposing the Revolution were killed by drowning in Nantes. The French Revolution was very violent.[253] It is estimated that during the reign of terror a total of 40,000 people were killed by the revolutionaries, in addition to all those who lost their lives because of famine, disease or war; half a million were imprisoned.[254] "Be my brother, or I will kill you," one of the revolutionaries exclaimed. By contrast, on the other side of the Channel, gradual reform led to liberal democracy, without a bloodbath.

No French author is more French than Honoré de Balzac, and no English author is more English than Jane Austen. Her *Sense and Sensibility* takes place in England in the 1790s. The three Dashwood sisters, Elinor, Marianne and Margaret, are living comfortably with their parents, Mr. and Mrs. Henry Dashwood, at a large country estate in Sussex, Norland Park. Elinor is sensible and reserved, whereas her sister Marianne is emotional and impulsive. The sisters have each inherited a thousand pounds from a relative. However, Norland Park is entailed: the property has to go undivided to Henry's son of a former marriage. So, the master of Norland Park has only 7,000 pounds at his disposal for his wife and daughters. On his deathbed, Henry extracts a promise from his son, John, that he will provide for his half-sisters and stepmother. John is independently wealthy, having inherited his mother, and his wife, Fanny, also is from a rich family, the Ferrars. But despite her wealth, Fanny is avaricious and talks her good-natured, but selfish and indulgent husband into reneging on his promise to his father. Immediately after Henry Dashwood's death, John and Fanny move into Norland Park, and the new mistress makes Mrs. Dashwood and her daughters feel unwelcome. Mrs. Dashwood wants to leave, but Elinor convinces her to stay for a while. They start looking for another accommodation, being constrained by their annual future income of 500 pounds, the return from the 10,000 pounds in their possession. Fanny's brother, Edward Ferrars, visits Norland Park, and forms an attachment to Elinor, much against the wish of his sister. Edward is pleasant, but shy and unassuming.

A rich relative of Mrs. Dashwood, Sir John Middleton, hears of her predicament and offers her and her daughters the use of one of his properties, Barton Cottage in Devonshire. Although the cottage is much more modest than Norland Park, they settle in and befriend the neighbours. One of them, the thirty five year old Colonel Brandon, who had served in the East Indies, has an income of two thousand pounds a year. Polite but aloof, he is attracted to Marianne, who finds him however too old. One rainy day Marianne goes out for a walk, slips and sprains her ankle. A handsome stranger comes galloping on his horse, picks her up and brings her home. He turns out to be John Willoughby who has a "pretty little estate of

Image of Jane Austen on the £10 note. In her novels, Austen described the injustice in denying women full inheritance rights and in entailing property.

251 Marx, *Kapital,* Vol. 1, repr. in *Werke*, Vol. 23, p. 615; *Kapital*, Vol. 3 [1894], repr. in *Werke*, Vol. 25 (1964), p. 49.

252 Mario Puzo, *The Godfather* (New York: G. P. Putnam's Sons, 1969), Epigraph. Probably Puzo got the quote from sociologist C. Wright Mills who misquoted Balzac in *The Power Elite* (New York: Oxford University Press, 1956), p. 95.

253 Left-wing intellectuals have consistently tried to play down the violence of the Revolution. Critical interpretations include Edmund Burke, *Reflections on the Revolution in France* (London: James Dodsley, 1790); Hippolyte Taine, *La Révolution*, Vols. 1–3 (Paris: Libraire Hachette, 1878–1883); and J. L. Talmon, *The Origins of Totalitarian Democracy* (London: Secker & Warburg, 1960). Recent interpretations include François Furet, *Penser la Révolution française* (Paris: Gallimard, 1978); and Simon Schama, *Citizens: A Chronicle of the French Revolution* (New York: Random House, 1989).

254 Donald Greer, *The Incidence of the Terror during the French Revolution* (Cambridge MA: Harvard University Press, 1935).

his own in Somersetshire,"[255] but is on a visit to his rich aunt on an estate nearby, expecting to inherit her. Marianne is attracted to Willoughby and does not heed Elinor's advice to restrain her feelings. But suddenly Willoughby leaves for London without any explanation. Edward Ferrars visits Barton Cottage. He is as friendly and polite as ever, but in low spirits. Later, another visitor appears, the vulgar and fawning Lucy Steele who is related to Lady Middleton. She tells Elinor in confidence that she is secretly engaged to Edward. Elinor realises that this is what caused Edward's sadness. He is bound to honour the engagement. Elinor and Marianne are invited to stay for a while in London. At a ball, they come across Willoughby in earnest conversation with a woman. He barely acknowledges Marianne who leaves in shock. It turns out that he is engaged to that woman who is rich, worth fifty thousand pounds. Marianne is devastated.

Colonel Brandon visits the Dashwood sisters and reveals that Willoughby is a scoundrel. He had seduced a young girl who was the Colonel's ward. The reason he had so suddenly left for London was that his rich aunt had learned about his behaviour and cut him off. The return from Willoughby's own estate has not been sufficient to sustain him, and he is heavily in debt. Lucy Steele comes to London and tells Fanny Dashwood that she is secretly engaged to her brother, Edward Ferrars. Fanny and her mother, Mrs. Ferrars, react angrily to this revelation, and when Edward refuses to break the engagement, his mother disinherits him in favour of his brother, Robert, whom Elinor finds a most disagreeable person. Colonel Brandon offers Edward a parsonage under his control, Delaford, so that he can take orders and become married. Elinor and Marianne leave London and visit the sister of Lady Middleton at Cleveland estate. Marianne catches a bad cold and gets ill. Willoughby visits and tells Elinor that he still loves Marianne despite being married. When Marianne recovers, she realises that she could never have been happy with Willoughby. Sense has taken the place of sensibility.

Edward Ferrars arrives and tells Elinor that Lucy has broken the engagement and married his brother Robert. Elinor briefly loses her composure and bursts into tears of joy. Subsequently, Edward asks for her hand. But Edward and Elinor still face difficulties: "Edward had two thousand pounds, and Elinor one, which, with Delaford living, was all that they could call their own; for it was impossible that Mrs. Dashwood should advance anything; and they were neither of them quite enough in love to think that three hundred and fifty pounds a-year would supply them with the comforts of life."[256] Edward approaches his mother who agrees to settle a small sum on him so that he can marry. Colonel Brandon proposes to Marianne who accepts. "Marianne Dashwood was born to an extraordinary fate. She was born to discover the falsehood of her own opinions, and to counteract, by her conduct, her most favourite maxims. She was born to overcome an affection formed so late in life as at seventeen, and with no sentiment superior to strong esteem and lively friendship, voluntarily to give her hand to another!"[257] The two married sisters, Elinor Ferrars and Marianne Brandon, are close. They live without disagreement between themselves, and with no coolness between their husbands.

Piketty is certainly right that money matters a lot in *Sense and Sensibility*, although the novel is curiously detached from the tumultous events of the time, such as the war against revolutionary France. Nothing very dramatic happens: the most exciting events are when Marianne Dashwood wanders out by herself, spraining her ankle the first time, catching a cold the second time. None of the protagonists holds a job. They spend their time travelling, visiting one another, chatting, drinking tea, playing music, and reading books. Nevertheless, the story is well told and captures the interest of the reader. It is, like the story in *Père Goriot*, about the formation of character, but in a very different way: Rastignac is tempted and ultimately corrupted by Parisian society, whereas Marianne becomes sensible like her sister, learns to control herself and seek propriety. It was when she was still guided by her emotions that she dreamt of an extravagant life, telling her sister that "a proper establishment of servants, a carriage, perhaps two, and hunters," could not be supported by less than two thousand pounds a year.[258] The point made previously

255 Jane Austen, *Sense and Sensibility* [1811] (Ware, Hertfortshire: Wordsworth, 1992), p. 29.

256 Ibid., p. 251.

257 Ibid., p. 254.

258 Ibid., p. 61.

Elinor and Marianne Dashwood with their mother, in the film from Austen's Sense and Sensibility. If the three Dashwood sisters had shared with their brother the estate from their father, then it would have been split into four parts. Photo: United Archives/Alamy.

about the precariousness of capital applies to one of the main characters: Willoughby, like some of the characters in Balzac's novel, has lived beyond his means, accumulated debt and needs to clear it by marrying an heiress. He has dissipated his inherited capital, his "pretty little estate".

Sense and Sensibility is about inequality, but not of the kind about which Piketty worries. It is about the inequality between the sexes, or the discrimination of women, on the one hand and the inequality between the first son (or sometimes the favourite child) and other children in a family on the other hand. Norland Park brought in 4,000 pounds a year, Austen tells us. If the four children of John Dashwood would have inherited the property equally, then each of them would have had an annual income of 1,000 pounds. Disregarding other variables, the 'Gini coefficient' for this group of four would have been 0, or perfect equality. Instead, John Dashwood enjoyed all the income. The 'Gini coefficient' therefore was 1, or complete inequality. The misfortune of the Dashwood sisters was compounded by the fact that their real choice was between marriage and an idle, depressing spinsterhood. Women of their class were not supposed to work, except perhaps as governesses or companions to noblewomen if unmarried. In England, as in other Western countries, women had very limited options in early nineteenth century. Their husbands controlled all their property. Divorce was difficult and they usually did not get custody of the children. This gradually changed in the nineteenth and early twentieth century, as women gained the same legal rights as men. Probably it would be fair to regard Jane Austen as a moderate rather than extreme feminist: In her novel, kindness is not an attribute of sex or wealth. Sir John Middleton is rich and kind, Lucy Steele poor and unkind.

The inequality between the sexes was created and maintained by the state and would disappear if the legal statutes upholding them would be abolished. So was also the inequality, vividly described by Austen, between the eldest son in a family and the other children, based on entailment and primogeniture: the right of the eldest son to inherit all the land belonging to the family. Adam Smith criticised primogeniture, writing that "nothing can be more contrary to the real interest of a numerous family, than a right which in order to enrich one, beggars all the rest of the children." He argued that the laws upholding entailment and primogeniture were absurd:

> "They are founded upon the most absurd of all suppositions, the supposition that every successive generation of men have not an equal

> right to the earth, and to all that it possesses; but that the property of the present generation should be restrained and regulated according to the fancy of those who died perhaps five hundred years ago.[259]

In the nineteenth century such laws were abolished in most countries, removing an important source of inequality.

Piketty is right that skilled novelists can depict social forces "with a verisimiliture and evocative power that no statistical or theoretical analysis can match". But what is remarkable about Austen's novel, *Sense and Sensibility*, and to a lesser degree about Balzac's novel, *Père Goriot*, is that they are not about the poor. They are about the rich, and those who aspire to be rich. The poor hardly make an appearance in Austen's novel, and the lodgers at Madame Vauquer's boarding house are by no means destitute: Rastignac comes from a family of landowners in the South of France, and Goriot and Victorine have an annual income which enables them to live modestly without working. If Piketty had been interested in the condition of the poor in the nineteenth century, then he would have found moving accounts of it in the novels by Charles Dickens, Victor Hugo and Émile Zola, none of whom is mentioned in his book.[260] But of course, if Piketty had focused on the poor, and not the rich, then he would have come up against the indisputable fact that in the nineteenth century the general condition of the poor improved in the United Kingdom where the data are most reliable.[261] A distinguished economic historian, Harvard Professor Jeffrey Williamson, writes that "unless new errors are discovered, the debate over real wages in the early nineteenth century is over: the average worker was much better off in any decade from the 1830s on than any decade before 1820."[262] It also improved elsewhere. Indeed, in 1899 German social democrat Eduard Bernstein wanted to revise the programme of the Social Democratic Party precisely because the workers were not becoming poorer, as Marx had predicted, although Bernstein's proposal was not accepted at the time.[263]

It is always hard to be poor. Undeniably, the poor in the nineteenth century, whether in Great Britain, France or the United States, or anywhere else for that matter, faced several obstacles if they wanted to better their condition. Nevertheless, there was much social mobility, as the example of Jane Austen's own family showed. Although her father was an Anglican rector who had to supplement his modest income by taking in a few students every year, the Austen brothers did well in life. Edward was adopted by a childless rich relative and his wife and inherited all their wealth. He put a nice cottage in Steventon in Hampshire at his sister's disposal. Henry became a banker in London and helped Jane with publishing her novels. However, mobility can be downwards as well as upwards: Henry's bank went bankrupt in 1816, and he left London and became rector of Steventon. On the other hand, Francis became Admiral of the Fleet and gained a knighthood. The youngest brother, Charles, became Rear Admiral.[264]

Possibly some glimpses from real life in the nineteenth century also have "a verisimilitude and evocative power" in Piketty's terms. In 1859, Scottish social reformer Samuel Smiles published *Self-Help,* a readable collection of true success stories demonstrating the benefits of thrift, hard work, education, perseverance and sound moral character:

> It is not accident, then, that helps a man in the world, but purpose and persistent industry. These make a man sharp to discern opportunities, and turn them to account. To the feeble, the sluggish, and purposeless, the happiest opportunities avail nothing, — they pass them by, seeing no meaning in them. But if we are prompt to seize and improve even the shortest intervals of possible action and effort, it is astonishing how much can be accomplished.[265]

259 Smith, *Wealth of Nations,* Bk. III, Ch. II, p. 384.

260 Hugo's novel, Les misérables, is however mentioned once.

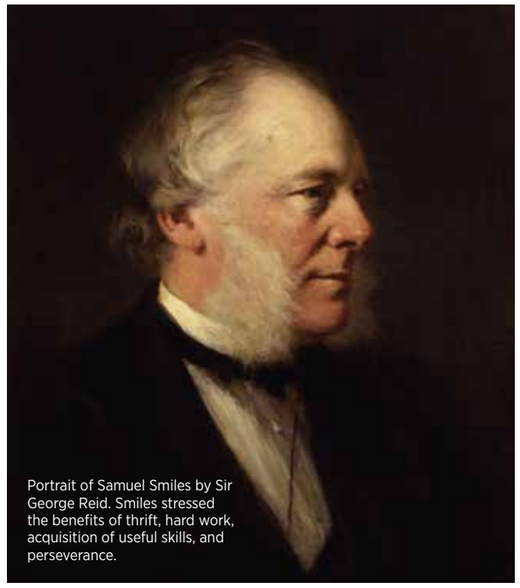
261 *Capitalism and the Historians* (Chicago: University of Chicago Press, 1954); *The Long Debate on Poverty: Eight Essays on Industrialisation and 'The Condition of England'* (London: Institute of Economic Affairs, 1972).

262 Jeffrey Williamson, *Did British Capitalism Breed Inequality?* (Boston: Allen & Unwin, 1985), p. 18.

263 Eduard Bernstein, *Die Voraussetzungen des Sozialismus und die Aufgaben der Sozialdemokratie* (Stuttgart: J. H. W. Dietz, 1899). His book was discussed for days at the Congress of the Social Democratic Party in 1899.

264 Claire Tomlin, *Jane Austen: A Life* (New York: Vintage Books, 1999).

265 Samuel Smiles, *Self-Help: with illustrations of Character and Conduct* (Boston: Ticknor and Fields, 1861, 1st ed. 1859), p. 108.



Portrait of Samuel Smiles by Sir George Reid. Smiles stressed the benefits of thrift, hard work, acquisition of useful skills, and perseverance.

James Watt, the son of a Schottish shipwright, built the steam engine. "For ten years, he went on contriving and inventing, with little hope to cheer him, with few friends to encourage him, struggling with difficulties, and earning but a slender living at his trade."[266] Richard Arkwright came from a poor family and never attended a school. Nevertheless, he invented the spinning frame. Josiah Wedgwood, the son of a poor potter, had only the use of one leg, but developed a new technique to manufacture stoneware. Active in the anti-slavery movement, he was the grandfather of Charles Darwin. William Harvey showed great perseverance, spending not less than eight long years of investigation and research before he published his views of the circulation of blood. Edward Jenner face no less difficulties than Harvey in promulgating and establishing his discovery of vaccination as a preventive of smallpox. Smiles gives countless other examples of successful artists as well as businessmen, manufacturers and scientists. I could add an example, having written a biography of the novelist Halldor Kiljan Laxness. Suffering one humiliating defeat after another early in his career, he did not give up, worked hard and eventually became the only Icelander to receive the Nobel Prize.[267]

Smiles' *Self-Help* became a best-seller and was translated into many languages, including Icelandic, then only spoken by about 70,000 people.[268] Perhaps to some extent his message gave rise to the mistaken assumption that wealth is often well deserved and thus a sign of virtue.[269] While this was partly recognised by Smiles who indeed thundered himself against greed, money for money's sake,[270] Alexis de Tocqueville offered a subtler account of character-building under capitalism:

> The principle of interest rightly understood produces no great acts of self-sacrifice, but it suggests daily small acts of self-denial. By itself it cannot suffice to make a man virtuous; but it disciplines a number of persons in habits of regularity, temperance, moderation, foresight, self-command; and if it does not lead men straight to virtue by the will, it gradually draws them in that direction by their habits. If the principle of interest rightly understood were to sway the whole moral world, extraordinary virtues would doubtless be more rare; but I think that gross depravity would then also be less common.[271]

Smiles's book was nevertheless an inspiration for many a person of humble origin who understood from his examples and advice that all is not lost until hope is lost. On the whole, his message had a salutory and beneficial effect. It may have been an instance of a 'symbolic truth'—a belief which is not strictly speaking correct, or provable, but which can be highly useful in daily life. Here, a version of Pascal's Wager is in place:[272] We should bet on and behave as if Smiles is right that self-reliance and honesty will pay, even if sometimes this may not be true because in the marketplace rewards inevitably depend less on what we do than on what others think of our efforts or on the circumstances in which we find ourselves.

266 Ibid., p. 44.

267 Gissurarson, *Halldor Kiljan Laxness,* Vols. I–III (Reykjavik: Almenna bokafelagid, 2003–2005).

268 Samuel Smiles, *Hjalpadu ther sjalfur* (Reykjavik: Sigurdur Kristjansson, 1892). Interestingly, another book by Smiles was also translated into Icelandic, *Thrift,* as *Sparsemi* (Reykjavik: Hid islenska thjodvinafelag, 1885).

269 Hayek, *Law, Legislation, and Liberty,* Vol. II, p. 74.

270 Smiles, *Self-Help,* p. 303.

271 Tocqueville, *De la démocratie en Amérique*, Vol. II, Bk. 2, Ch. VII (Paris: C. Gosselin, 1840). Trans. by Henry Reeves.

272 Pascal, *Pensées* (1670), §272.

10

SOCIALISM IN ONE COUNTRY

We have seen that the main difference between John Rawls and Thomas Piketty is that Rawls was worried about the poor whereas Piketty is concerned about the rich. But they have in common that their theories can only be realised in a closed country: If free movement of capital were allowed across borders, then their redistributive programmes would hardly be sustainable. The redistribution required if the worst off in Rawls' scheme would include the inhabitants of, say, Haiti or Congo would be so drastic that it would be beyond the powers of elected authorities in affluent democracies. In 2017, 1 billion people lived in Subsaharan Africa. It was the poorest region of the world with an average income (GDP per capita) of $1,574. Then, 325 million people lived in the United States with an average income of $59,531.[273] Clearly, global redistributive taxes on ordinary citizens in the United States and other affluent societies would be punitive. The numbers are staggering. Therefore, Rawls had to stipulate that his worst-off group lived in an affluent society and that redistribution on his principles was confined to that society. And therefore, also, the confiscatory taxes that Piketty wants to impose on the income and assets of the very rich have to be global. He wants to deny wealthy people the opportunity to move from Sweden to Switzerland in order to lighten their tax burden. Both Rawls and Piketty must insist on 'Socialism in one country' where the meaning of socialism has changed from public ownership of the means of production and central planning to extensive redistribution through taxes and welfare benefits.

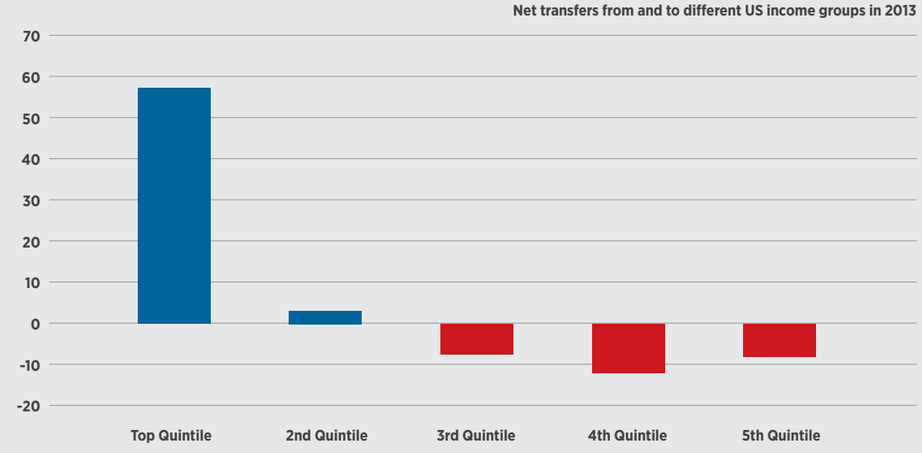
In order to implement their redistributive programmes, Rawls and Piketty have to hold the most productive group in society captive, as they both implicitly realise. One way of seeing this is by looking at the distribution of the tax burden. In 2013, a year before Piketty published his book, data from the US Congressional Budget Office showed the average tax payments and received benefits of five groups of households by income. The top quintile had an average market income of $253,000 and the bottom quintile of $15,800. On average, the top group paid $69,700 in federal taxes and the bottom quintile $800. The three low-to-middle income groups received more transfers than they paid in taxes: only the two high income groups received less. The top quintile paid $57,700 more on average than it received and the second quintile $2,600, whereas the third quintile received $7,800, the fourth quintile $12,200 and the fifth quintile $8,800. In other words, it was the top quintile, the 20 per cent high-income households, which financed the US welfare state. This is illustrated in Figure 7. For each dollar that the highest quintile paid in taxes, it received 17 cents, the second highest quintile 85 cents, the middle quintile $1.88, the second lowest quintile $4.05 and the lowest quintile $12.[274] Data from other countries confirm this general conclusion although in Europe the poor pay relatively more in taxes and the rich relatively less than in the United States.

Data like these could be used in a thought experiment. Assume that the highest income group in a high-tax country suddenly decides to emigrate, say from Sweden to Switzerland or from California to Florida, and that somehow they would meet few legal or social obstacles. We recall that this is the theme in Ayn Rand's *Atlas Shrugged*, except that there the producers, refusing to provide for the rest, retreat to an unknown destination up in the mountains: they 'emigrate upwards'. What would happen if the 10 or 20 per cent richest group in a country would leave? Piketty might reply that others could take their place,

273 World Bank. GDP per capita, current US$ (online).

274 Calculations by Economics Professor Mark J. Perry, in his blog of 13 June 2016. http://www.aei.org/publication/cbo-study-shows-that-the-rich-dont-just-pay-a-fair-share-of-federal-taxes-they-pay-almost-everybodys-share/

FIGURE 7
THE RICH PAY FOR THE WELFARE STATE



Source: Professor Mark J. Perry.

but it would not be a very convincing answer: Even if some of the rich undoubtedly came to their wealth by inheritance or luck, nevertheless the group as a whole would possess a relatively large amount of human capital. It is more likely that after its emigration production would plunge in the high-tax country with the result that tax revenues would also go down dramatically and consequently the ability to maintain welfare benefits like those enjoyed by the lowest quintile in the United States in 2013 whose received benefits exceeded their tax payments by $8,800 per household on average. There would be little left to redistribute. This is what in recent times happened in countries like Cuba and Venezuela where millions of people, many of them middle class professionals, left.

The country receiving the rich would however benefit. Even if they would have to leave their tangible assets behind, they would bring with them a considerable amount of human capital. The relatively affluent people of Indian origin that Uganda Dictator Idi Amin expelled in 1972 arrived almost penniless in the United Kingdom. But after a while most of them had become affluent again.[275] In a course I taught on political economy at the University of Iceland one of the standard questions I asked my students was: If you are a member of an unpopular minority in a country, what advice would you give your children about their future strategies? Should they for example invest in real estate or education? I argued that they should invest in education because if they needed to escape, then they could bring their human capital with them, but would probably have to leave behind most of their physical capital.[276] Communist East Germany was perhaps the best example of a country where the government not only appropriated almost all physical capital, but also held that all human capital was owned by the public and not by the individuals in whose possession it was. To stop the massive flow of human capital to capitalist West Germany, the government in 1961 built the Berlin Wall.

In real life there are of course many obstacles to leaving your motherland for tax reasons. If you live in a small and cohesive country with a democratic tradition, then you may feel solidarity with and loyalty to your fellow citizens.[277] In Europe an immigrant may have to learn a new language unlike those who move from California to Florida. He is leaving the certainty of known circumstances for something

275 Paul Harris, They fled with nothing but built a new empire, *The Observer* 11 August 2002.

276 This point was made, for example, in Armen A. Alchian and William R. Allen, *University Economics* (Belmont CA: Wadsworth, 1964).

277 There, the two alternatives to exit: voice and loyalty, may seem more attractive as ways to respond to decline or discontent. Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizationa, and States* (Cambridge MA: Harvard University Press, 1970).

The Berlin Wall was an extreme example of a government trying to stop the outflow of human capital. Photo: Bundesarchiv B 145 PO-61246.

new and risky. Nonetheless, globalisation—the increase in international free trade coupled with vast improvements in transport and telecommunications—has removed many social and economic barriers to migration and capital transfers. Capital controls have largely disappeared. Tax competition has become easier, where local communities and countries try to attract rich individuals and multi-national corporations by offering low taxes and perhaps also, although not necessarily, secrecy and flexible regulation.

One argument for tax competition rests on the fact that the traditional theory of public goods has little to say about how much of a public good should be produced. We might agree that defence and public security are pure public goods whose adequate provision has to be ensured by the state. But what counts as being adequate? Similar considerations apply to the two goods which are most often associated with the welfare state, provision for the poor (a safety net) and primary education. Let us assume for argument's sake that they indeed are public goods and should be produced with taxpayers' money. But how much should be produced of each of them? Tax competition is a spontaneous or non-coercive answer to that question. You choose the community or country where the quantity produced of public goods is in accordance with your wishes and preferences.[278] If you prefer a large quantity of public goods, then you move to a community or country which provides such a quantity, accepting the high taxes entailed. If you prefer a more modest role for government, then you move in the opposite direction. You vote 'with your feet', like those who left Cuba on boats, rafts and barges voted 'with their oars'.

Tax competition, then, is a form of discovery procedure. It enables us to discover the optimal quantity of public goods. Another argument for tax competition is that it will constrain government. if it grows too big and costly, then productive people paying high taxes will leave. Knowing this, decision makers, not only politicians and bureaucrats, but also recipients of welfare benefits, will take care not to go too far. Rational individuals do not kill the geese who lay golden eggs, especially not if they have wings and can fly away. This is the development which Piketty deplores: In many countries, the wealth tax and the inheritance tax were abolished or reduced in the 1980s and 1990s, while personal and corporate income taxes were lowered. This was not necessarily because politicians and bureaucrats liked tax cuts, although certainly there was a political constituency for them. It was rather because the tax collectors did not want wealthy people and big corporations to leave. Moreover, the other side of exit is entry. Some countries have explicitly lowered taxes in order to attract big corporations, for example Ireland which offers a corporate income tax of 12.5 per cent and has become a magnet for multi-national corporations such as Google, Apple and Facebook which locate some of their financial operations there.[279] Switzerland has also long been a popular destination for capital, because of her political stability and favourable tax rates.[280] Many small islands in the Caribbean have sought to become 'tax havens', following the examples of the Isle of Man and the two Channel Islands, Jersey and Guernsey. More modest programmes are in place in some countries. Portugal for example offers pensioners from other countries 10 years of residence with their pension income tax-free.[281]

The argument from constraint is probably the reason why those in favour of big government (or, as they would say themselves, in favour of a large quantity of public goods) are hostile to tax competition and seek to raise legal barriers to it. They have been able to rally international organisations such as the OECD and the EU to their cause. In 1998, for example, OECD published a report on *Harmful Tax Competition*.[282] It has repeatedly reinforced its message and also publicly endorsed Piketty's view that income and wealth inequality is of grave concern.[283] The EU maintains a 'black list' of non-cooperative jurisdictions and a 'gray list' of jurisdictions that are cooperative, but offer favourable tax rates for foreign capital. In December 2018 five countries were on the black list, American Samoa, Guam, Samoa, Trinidad and Tobago and US Virgin Islands. Then, 63 jurisdictions were on the gray list, including many Caribbean islands, the Channel Islands, Switzerland, South Korea, and North Macedonia.[284] However, two EU member states that have tried hard to attract foreign capital, Cyprus and Malta, were not on either of the two lists. In the 2008 financial crisis, the US government made it a precondition for liquidity assistance to the Swiss National Bank that Switzerland would relax her strict bank secrecy laws.[285]

The EU wants to replace tax competition with what it calls 'tax harmonisation' which would mean, for example, that Ireland would not be allowed to keep her taxation of corporate income at its present low level. In this endeavour, the EU has a forerunner. In mid-19th century Germany was divided into many different states, including the old Hansa towns Hamburg, Bremen and Lübeck. Many of those states pursued liberal trade policies and facilited competition across their borders, for example by the German Customs Union of 1833. But under Bismarck, Prussia became the dominant power, defeating Denmark in 1864 and Austria in 1866 and annexing Hannover, Schleswig-Holstein, Kurhessen, Nassau and the city of Frankfurt and forcing the North German states into the North German Federation which was then replaced by the German Empire in 1871 when the Southern and Western states like Bavaria, Baden and Württemberg recognised the Prussian king as German Emperor. As Chancellor of the Empire, Bismarck systematically tried to further the economic interests of the ruling elites of Prussia and other agrarian Eastern states, against the opposition of the old Hansa towns and the relatively liberal states of Baden, Württemberg and Hesse. His aim was, as German economist Roland Vaubel observes, to 'raise his rivals' costs', not only by federal regulation, but also by imposing excise and custom duties.[286] He was in effect establishing a cartel of the more interventionist states against the more competitive ones. The development of the German Customs Union into the German Empire seems to be to some extent paralled by the gradual transformation of the European Union since its inception in 1956 from an open market to a closed state.

278 Charles Tiebout, A Pure Theory of Local Expenditures, *Journal of Political Economy,* Vol. 64, No. 5 (1956), pp. 416–424.

279 Brendan Walsh, The Celtic Tiger, *Cutting Taxes,* pp. 105–120.

280 Pierre Bessard, Tax Competition: the Swiss Case, *Cutting Taxes,* pp. 85–104.

281 Nicole Blackmore, The ultimate pension freedom: Retire in Portugal and reduce your tax, *The Telegraph* 7 April 2015.

282 *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998).

283 *The Great Divergence(s): The link between growing productivity dispersion and wage inequality,* STI Policy Note (Paris: OECD, May 2017).

284 Evolution of the EU list of tax havens, 4 December 2018. https://ec.europa.eu/taxation_customs/sites/taxation/files/eu_list_update_04_12_2018_en.pdf

285 *The Swiss authorities under the pressure of the financial crisis and the disclosure of UBS customer data to the USA*. Report of the Control Committee of the Federal Assembly (Bern: 31 May 2010). https://www.parlament.ch/centers/documents/en/bericht-gpk-ns-ubs-kundendaten-usa-2010-05-30-res-e.pdf

286 Roland Vaubel, Comment: The Strategy of raising Rivals' Costs by federal regulation under Bismarck, *Political Competition and Economic Regulation* (London: Routledge, 2007), pp. 194–199.

Dusk at Lake Zürich, Switzerland. Tax competition helps us to find the optimal quantity of public goods to be produced. Photo: Dominic Kamp.

The proponents of the campaign against tax competition apparently confuse it with the operation of tax havens, where special favours, normally not available to ordinary citizens within the jurisdiction, are offered to foreign corporations which choose to register there. The case for tax competition is not based on such tax havens, even if there may be independent arguments for them. For example, bank secrecy served to protect Jews in Nazi Germany who could hide some of their assets in Swiss banks, and it may today enable businessmen under corrupt, extractive governments in Latin America or Africa to save some of their assets for better times or better places.[287] Tax planning is normally legal: It consists in moving income and assets around in such a way that tax payments from them are reduced to the minimum required. My distant cousin, world-famous Icelandic singer Björk,[288] who does not conceal her left-wing sympathies, once said in an interview: "When we were preparing to record 'Post', my accountant called me very upset, and said unfortunately we might have to go to the Bahamas. It was to save a lot of money on taxes, so we got our bikinis sorted and left."[289] I see nothing wrong in what Björk did. She is a businesswoman, selling a service popular all around the world. People who deliberately pay more than they need to do, are rarely good businesspeople. It is foolish to run a business at a loss. Many other celebrities with an international audience do not pay taxes in their countries of origin.

Sometimes tax planning is regarded as self-evidently prudent. In Iceland you can take as much as you want out of your private pension account after you reach 65 years; and the personal income tax has two brackets. When I once inquired about future pension payments at the Government Employees' Fund, the consultant cheerfully said: "But then you have of course to take annually so little out of your private pension account in addition to your pension from us that you remain below the higher tax bracket." Again, I seen nothing wrong with this advice. But tax planning should be distinguished from tax evasion which takes place if one knowingly gives wrong information about one's income or assets in order to lower tax payments from them or if one tries to hide one's wealth because it was illegally obtained, by bribes or extortion for example. There, a revised version of Balzac's maxim in *Père Goriot* may apply: Behind every hidden and unexplained fortune there is a crime.

The case against tax competition seems to rest on two arguments. One is that it might lead to a 'race to the bottom'. If corporations and wealthy individuals would move to low-tax jurisdictions, the welfare state would be deprived of its main sources of funding and consequently not be able to fulfil its obligations to the needy. This is however illogical and implausible. While certainly the rich, and the corporations in which they hold stock, are the main sources of tax revenue, it is by no means clear that the present quantity of public goods produced in a typical Western country is optimal, although that seems to be the implicit premise of the argument. From an economic point of view the optimal quantity of public goods, including a safety net for the poor, has to be determined. Logically, it should be that at the point where any change in either direction would make some individuals or groups worse off. Then it would be Pareto-optimal. If a rich person chooses to emigrate from a country for tax reasons, then he is revealing his preferences about the quantity of public goods. He wants less of it. His preferences should count for as much as those of others. Anyway, in the real world the increased tax competition in the 1980s and 1990s does not seem to have starved the welfare state.

The second argument against tax competition is that it creates an unfair advantage for those who are in possession of mobile capital like bank deposits, bonds and stocks, over those who have nothing to sell but unskilled labour. The tax refugees become 'free riders' on the rest of society, enjoying the advantages of Western civilisation without contributing to it. In fact it is only partly true that the owners of mobile capital are at a special advantage: people with special talents can sell them almost everywhere, and if given the opportunity unskilled labour would move from low-income to high-income countries, from Egypt to Italy and from Mexico to the United States, not necessarily pursuing welfare benefits, but rather better jobs than are available in their countries of origin. Nevertheless, we should accept that with the abolition of capital controls its owners are able to move it around. But again, the premise of this argument is that the present quantity of public goods is optimal, and that those who emigrate because they do not accept the expropriation of their money are somehow harming others. But a distinction has to be made between two senses of 'harm'. One is when you do something to another person, for example when you bludgeon or rob him. The other sense is when you do something that may result in a loss for him, for example if you switch your business from his company to his competitor or if you accept one suitor, rejecting the others. The first kind of harm is immoral and unjust, whereas the second one is not: you are free to choose between the goods or services offered by others. The harm the rich inflict on other citizens by moving abroad is of the second kind. It means a loss for the remaining citizens, but it is not in itself an unjust act.[290]

An exodus of the rich for tax reasons certainly would mean that they would cease to subsidise the production of public goods for others in their old country. But it should not really affect much the production of pure and perfect public goods there. A public good is either produced at a proportional or a fixed cost. If the cost is proportional, then the total cost decreases equally with each person leaving. If the cost is fixed, the situation is different: There may be economies of scale where the production of a public good costs less the more people are paying for it, although that would be argument against most people emigrating and not only the rich. But it turns out that there are also diseconomies of scale.[291] Public security tends for example to cost more per person in large and heterogenous societies like the United States than in small and homogeneous societies such as the Nordic countries. The argument seems to be straightforward in the case of emigration: the emigrant accepts the quantity of public goods provided in his adopted country, paying his taxes there. The reasonable rule that taxes should be paid in the country where income is generated should also eliminate any 'free riders'.

The question remains how to deal with individuals and corporations that can to a large extent define themselves the location of their tax base, for example athletes and entertainers with an international audience or multi-nationals. It seems that those individuals who earn their income internationally and

287 Richard W. Rahn and Veronique de Rugy, Threats to Financial Privacy and Tax Competition, *Policy Analysis,* No. 491 (2 October 2003).

288 Her great-great-grandmother was sister of my great-great-grandfather. In tiny Iceland, everybody is related.

289 Interview in *QX Magazine* (December 1996). https://14142.net/bjork/articles/bjork/qx.txt

290 Pascal Salin, The Case Against 'Tax Harmonisation': The OECD and EU Initiatives, *Cutting Taxes,* pp. 61–84.

291 Gissurarson, *In Defence of Small States* (Brussels: New Direction, 2017).

are engaged in tax planning, choosing their tax base in the least costly location, like Björk did by recording her album in the Bahamas, are not committing any injustice. The same applies to a multi-national that moves to Ireland. Moreover, it may even sometimes be better for the citizens of the multi-national's old country because less of the return to capital of the multi-national will be absorbed by the new country so that more will eventually be paid out in dividends to the stockholders residing in the old country. This seems to be the case with Google, Apple and Facebook that have most of their tax base in Ireland, but whose stocks are mostly owned by residents of the United States. As Adam Smith remarked, the rich cannot really eat much more than the rest of us: they either consume or invest what they receive, and thus their wealth circulates.

Tax competition between states puts pressure on governments faced with the possible exodus of the rich to reform some of their more distortionary taxes. Any tax on capital and its return, such as a wealth, inheritance or capital gains tax, is distortionary and should not exist according to economic theory, despite Piketty's call for such taxation. The reason is that it discriminates against the future by imposing a heavier tax burden on it than on the present. Consider two persons who could be called names from Jane Austen's *Sense and Sensibility*, Mr. Willoughby and Colonel Brandon. They originally have the same annual income and pay a tax on it. Willoughby is a dissolute gambler who spends all his after-tax income and even dissipates some of his capital (as the Willoughby of the novel indeed did). Brandon is a sensible and thrifty person who saves half his after-tax income from his estate, investing in stocks and bonds. If a tax on capital returns such as dividends and interest is imposed in addition to the tax on income, then Willoughby does not pay a penny because his tax base disappeared by him consuming it all, whereas Brandon who had already paid a tax on all his income, will also have to pay a tax on the dividends from his stocks and interest from his bonds, which is a clear case of double taxation. Similar considerations apply to rent. If I rent a house from you, then it should be recalled that you used past income to buy or build the house. If the rent is taxed, past income is being taxed for the second time. A tax on capital or its returns favours the present over the future and the prodigal over the thrifty. In Piketty's terminology, the present devours the future.

Another distortionary tax is a progressive income tax, for example if you tax the quintiles on the income scale at the different rates of 0, 20, 40, 60 and 80 per cent respectively. Such a progressive tax discriminates against the rich by imposing a relatively heavier tax burden on them than on the poor. In the Ottoman Empire and other Muslim states, special taxes or surcharges were imposed on Christians and Jews. According to the English income tax statute of 1691, Protestants were taxed at a certain rate, Catholics, as a class, at double the rate of Protestants, and Jews at another and separate rate.[292] Is the discrimination against the rich nowadays any better? Some might respond that the difference is that the tax burden should fall on the broadest backs. But this would already be accomplished by a flat income tax of, say, 33 per cent. Obviously, a third of a high income is much more than a third of next to nothing. Another common argument is that an additional tax payment, say, of €10,000 makes much less difference to the rich than it would to the poor. In the terminology of economists, the transfer would reduce the marginal utility of the rich much less than that of the poor.[293] While this argument would only hold sway with utilitarians, it is not necessarily plausible on their terms. Perhaps the rich are rich because an additional €10,000 is worth more to them than to others. You might be an entrepreneur with a strong urge to experiment and innovate, continuously setting up new companies, and therefore not with a penny to lose. Or you might be a rich *bon vivant* spending a lot of money on food and wine and lamenting any loss of purchasing power.

Normally, people should be held responsible for their own actions. But a progressive income tax encourages political irresponsibility, when the majority who pay 0–40 per cent of their income in taxes are able to impose on the minority a 60–80 per cent income tax. Aristotle feared that direct democracy in the Greek city-state would lead to the exploitation of the rich by the poor, or rather by the demogogues who were

292 Walter J. Blum and Harry Kalven, The Uneasy Case for Progressive Taxation, *The University of Chicago Law Review,* Vol. 19 (1951), p. 423.

293 Friedrich von Wieser, *Der natürliche Werth* (Wien: Alfred Hölder, 1889), Bk. VI, Ch. 4, §6.

If the rich are such a problem, why do redistributionists then want to hinder their emigration?

leading the poor.[294] American economist and Nobel Laureate James M. Buchanan observes that it would seem fairer that those who vote for taxes should also pay them. Taxes, as payments for public goods, should in theory (not least Rawlsian theory) be acceptable to all, and not be imposed by some on others against their will. Productive people in a high-tax regime should be able to secede and form their own low-tax regime.[295] Perhaps this is one reason behind today's separatist movements in Catalonia, Northern Italy and Flandern.

A progressive tax also creates many complications, not all of them obvious at first sight. Members of a single household may try to distribute the total income of the household between the husband, the wife and the children in such a way that they all end up below a certain tax bracket. Individuals with fluctuating income will arbitrarily end up in different tax brackets from one year to another. Novelists are not all like Honoré de Balzac who wrote one book a year or more. If it takes a novelist like Jane Austen three years to write a book, she will be taxed lightly, if at all, for two years and heavily the third year when she receives her remuneration. It may take an entrepreneur several years to develop a business during which time he will pay low taxes, and then after it takes off, his net income from it may fluctuate wildly between years. Should he be allowed to even up his income between years? Would he not do so anyway? Progressive taxation also tends to reduce benefits from the division of labour. Consider a system analyst who is good at his work, but clumsy in handling things. He needs to have his house painted and his meals cooked, although he is a worse painter and cook than the professionals. If he, the painter and the cook all pay a flat 30 per cent income tax, then the system analyst will work longer hours and pay the two professionals for their services. However, if a progressive income tax were imposed on him, instead of working longer hours and pay 60 per cent on the additional income, he would probably himself paint his house and cook his meals.

Yet another effect of progressive taxation is that it discriminates against taking risks. Assume that an entrepreneur paying 30 per cent on his present income has one million euros at his disposal. He is interested in using the money for a particular investment whose chance of success he rates as being fifty-fifty: Either he will double its value or lose it all. If he succeeds, with progressive taxation he will move into a higher tax bracket and find himself paying, say, 60 per cent of the profit to the state. If he fails, his loss will be subtracted from his present income and the net income will be taxed at 30 per cent (or even less). After tax he could, in other words, either make a profit of €400,000 or suffer a loss of €700,000 on an investment where the chances of success are rated as being fifty-fifty. This clearly distorts his weighing of the alternatives. With progressive taxation he would take fewer risks than if he would pay the same 30 per cent on the possible additional income as he is now paying on his present income.

The crucial point is that tax bases are not immovable or fixed. Potential Pikettian tax collectors are like 'the man of system' that Adam Smith wrote about:

> He seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board. He does not consider that the pieces upon the chess-board have no other principle of motion besides that

294 Aristotle, *Politics,* Bk. V, Pt. V.

295 James M. Buchanan, The Ethical Limits of Taxation, *Scandinavian Journal of Economics,* Vol. 86, No. 2 (1984), pp. 102–114. Repr. in *The Collected Works of James M. Buchanan,* Vol. 14 (Indianapolis IN: Liberty Fund, 2000), pp. 211–227.

> which the hand impresses upon them; but that, in the great chess-board of human society, every single piece has a principle of motion of its own, altogether different from that which the legislature might chuse to impress upon it. If those two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously, and is very likely to be happy and successful. If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder.[296]

You act as well as react. You have your 'principle of motion' as Smith said. Even if you are barred from emigrating to another country, you have the alternative of emigrating 'inwards', in other words of changing your behaviour in order to lessen your tax burden.

Recall Martin Feldstein's argument against Piketty that the increased income inequality measured in the United States may partly be a statistical illusion because with Reagan's tax cuts highly paid executives and professionals chose to work longer hours and to take more of their income in taxable salaries and less of it in non-taxable financial arrangements such as government bonds or in perks. Assume that the tax cuts are reversed (on Piketty's advice!) so that high-income people such as business executives, stockbrokers, doctors in private practice and partners in prestigious law firms suddenly face a 80 per cent marginal income tax. It is plausible to expect them to change their behaviour. The doctors and lawyers would work shorter hours, and the business executives and stockbrokers would try to find ways of moving their income into other and less heavily taxed forms such as perks and retirement schemes. The high income earners would hire a veritable army of tax lawyers and accountants to advise them on tax matters, yet another invisible cost of a progressive income tax.

Arthur Laffer points out that the tax base may grow or shrink under different tax regimes. Photo: Saul Loeb/AFP/Getty Images.

This is the undeniable truth in the famous Laffer Curve which is shown in Figure 8.[297] The tax base can grow or shrink which implies that the state might sometimes obtain more tax revenue from lower tax rates if they are set in such a way that they stimulate growth. Conversely, tax revenue might in fact shrink when the tax rate is raised. It is difficult or well-nigh impossible to find out the exact shape of a Laffer Curve, but there is presumably an initial point of 0 per cent tax rate and zero revenue and an end point of 100 per cent tax rate and zero revenue again and somewhere in-between a point of maximal revenue (or perhaps some points) at a given tax rate. An example of a 'Laffer Effect' would be the difference in average income between the EU members states and the 50 states of the US. The reason it is lower in Europe is that the Europeans work less than the Americans, and the explanation for that in turn, American economist and Nobel Laureate Edward C. Prescott argues, is that they pay higher taxes.[298] If some would complain that this was more of a problem than a solution, since the additional income would come solely from additional labour, then the reply could be that the difference is that the Europeans do not have the same opportunity as the Americans to improve their living standards by working harder or longer. If some Americans on the other hand wanted to work shorter hours, and enjoy more leisure, then they probably could, but then they would have to accept less income personally. When Sweden in the 1970s and 1980s followed what we in Chapter 5 called the second Swedish model of very high taxation and extensive redistribution, perhaps she ended up on the wrong side of the Laffer Curve (the right side, as it were).

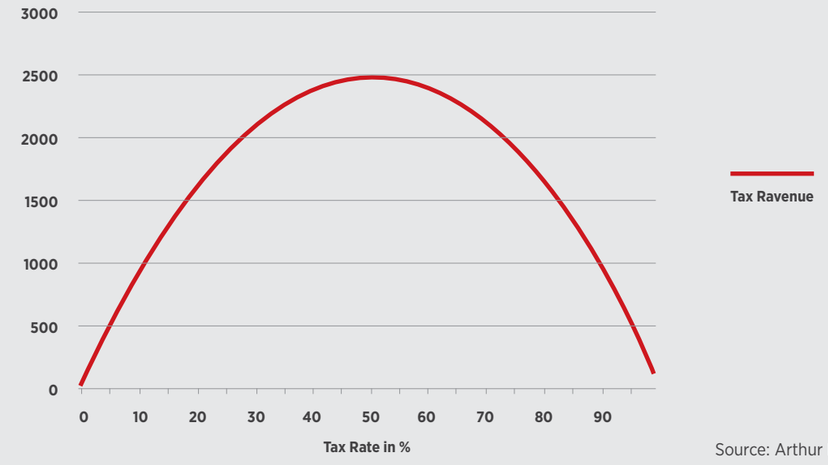
296 Smith, *Moral Sentiments*, Part VI, Section II, Ch. II, §17.

297 Arthur B. Laffer, The Laffer Curve: Past, Present, and Future, *Heritage Foundation Backgrounder,* No. 1765 (June 2004).

298 Edward C. Prescott and Johanan Wallenius, The Modern Theory of Aggregate Labour Supply and the Consequence of Taxes, *Cutting Taxes,* pp. 9–24.

FIGURE 8

THE LAFFER CURVE, WITH A GROWING OR SHRINKING TAX BASE



Source: Arthur Laffer

In Iceland, a natural experiment was conducted in 1986–1988 about the effect of taxation on the willingness to work. In 1986, the Treasury decided to move from a system under which taxes were paid on the previous year's income to a pay-as-you-earn system. This meant that the year 1987 became tax-free. That year people paid tax on income earned in 1986, and the next year they paid tax on income earned in 1988. The only problem with the experiment was that the decision to make the move was only made and announced in December 1986 which gave people limited time to adjust to the situation. Nevertheless, there was a marked change in people's behaviour during the tax-free year. The willingness to work, or employment rate, measured as the ratio of the total number of weeks worked to the potential labour supply, went up by 3 per cent. There was a slight difference between the sexes: the ratio went up 4.16 per cent for women and 2.36 per cent for men. The explanation for the difference was simple and obvious. A higher proportion of men than women were in full-time jobs where they could not change much the number of working hours put in. The GDP in 1987 also rose significantly: it was more than 4 per cent higher than the average of the two adjacent years 1986 and 1988. Thus, a significant 'Laffer Effect' could be identified in the tax-free year of 1987.[299] It is safe to conclude that this effect was the strongest in professions where working hours were relatively flexible. A possible and intriguing corollary of this is since high-income jobs usually have more flexible hours than low-income jobs that an efficient income tax, generating more growth and increasing the tax base, should be regressive: high-income groups should pay a smaller proportion of their income in tax than low-income groups. Groups with more elastic labour supply should pay less tax on their labour than others. While the logic may be unassailable, I think however that a regressive income tax would be no less desirable than a progressive one. Neither kind of tax would be just.

Another and more comprehensive experiment was conducted in Iceland about the corporate income tax. In 1985, it was 50 per cent. A part of the comprehensive free market reforms implemented by David Oddsson, Leader of the Independence Party, during his long tenure as Prime Minister in 1991–2004 was a series of tax cuts. In 2003, the corporate income tax had fallen to 18 per cent. But despite the great reduction in the tax rate, total revenue from the tax actually increased as a proportion of GDP, as can be seen in Figure 9. Of course the reduction of the rate was not the only reason: it combined with other factors such as fiscal and monetary stability after decades of government deficits and high inflation

299 Marco Bianchi, Bjorn R. Gudmundsson, and Gylfi Zoega, Iceland's Natural Experiment in Supply-Side Economics, *The American Economic Review,* Vol. 91 No. 5 (2001), pp. 1564–1579.

and a change in the attitude of Icelandic businessmen once they realised that the state was not going to subsidise failed enterprises, as it previously had been wont to do. But the crucial point was that the tax base grew. Only sustainable companies survived the new market discipline, and their profits rose and with that their tax payments. A smaller portion of a bigger cake can be larger than a bigger portion of a smaller cake. While the tax cuts continued after 2003, the end point in Figure 9 is set that year because in 2004 a credit bubble started which eventually led to the collapse in 2008 of the Icelandic banks.

American economist Arthur Laffer first sketched the curve bearing his name on a napkin in December 1974 when he was having dinner in the Two Continents Restaurant at the Washington Hotel with Dich Cheney, Assistant to President Gerald Ford, and White House Chief of Staff Donald Rumsfeld. Laffer was arguing against proposals for tax increases. It is an old insight. Arab scholar Ibn Khaldun had already in the fourteenth century taught that "at the beginning of a dynasty, taxation yields a large revenue from small assessments. At the end of the dynasty, taxation yields a small revenue from large assessments."[300] David Hume and Adam Smith had made similar observations, and John Maynard Keynes had argued "that to create wealth will increase the national income and that a large proportion of any increase in the national income will accrue to an Exchequer," whereas "taxation may be so high as to defeat its object, and that, given sufficient time to gather the fruits, a reduction of taxation will run a better chance than an increase of balancing the budget."[301]

The Laffer Curve is a heuristic device. It brings out the reasonable upper limit to taxation, just as Rawls' theory of justice sets an upper limit to redistribution. If the tax rate becomes so high that tax revenue falls, then taxation becomes self-defeating for any purpose other than harming the rich which is not, as we have discussed, a legitimate preference. It is not in the self-interest of politicians, bureaucrats and other government beneficiaries to go so far that they reduce their own gains. The conclusion is however not necessarily that the tax rate should, perhaps in a process of trial and error, be moved to the point at which tax revenue would be maximised, although politicans, bureaucrats and welfare recipients might want that. The purpose of taxation is hardly to maximise government revenue. Some economists suggest that the tax rate should rather be moved to the point at which economic growth would be maximised. While this is a more reasonable idea, it is not really what taxation should be about. As Friedrich von Hayek, Michael Oakeshott and other conservative-liberal thinkers have argued, the political order is not about the maximisation of anything. It is about the mutual accommodation of different individuals with often conflicting ends and aims. Accordingly, the tax rate ideally should be set at the point at which sufficient funds would be obtained to fulfil the legitimate and generally accepted functions of government, such as providing defence, public security and an adequate safety net. In our times however, with chronic public deficits and unsustainable pension obligations in many countries, the tax rate probably should be set at the point at which economic growth would be as rapid as possible, in order to secure sufficient funds to pay off the public debt and to reform the pension system. But this would presuppose benevolent and well-informed rulers, however likely that might be.

The conclusion is that Rawls and Piketty present redistributive programmes which hardly could be implemented, not only because they would require large bureaucracies and unrelenting enforcement agencies, but also because the tax base on which they would have to rely would shrink significantly. Eventually, they would run out of other people's money, as Margaret Thatcher once put it. Even if they would try to stop the possible exodus of the most productive or richest people (perhaps not identical groups, but certainly overlapping) either by closing the borders of their country or by imposing upon all alternative settlements the same tax regime, they could not hinder the 'emigration inwards' by which people would tend to withold their special talents, skills and expertise from those trying to expropriate the income from those abilities. Robert Nozick pointed out that taxation for the sole purpose of redistribution was on a par with forced labour: You are allowed to work for yourself part of the time, but then you have to work for others the rest of the time.[302] You become their serf. In a similar spirit, many supporters of the free market celebrate tax freedom days, which mean those days in which people cease to work for government and start working for themselves. The tax freedom days for countries reflect the proportion of taxes to GDP: if government takes half the GDP in taxes, then tax freedom day would be 1 July.

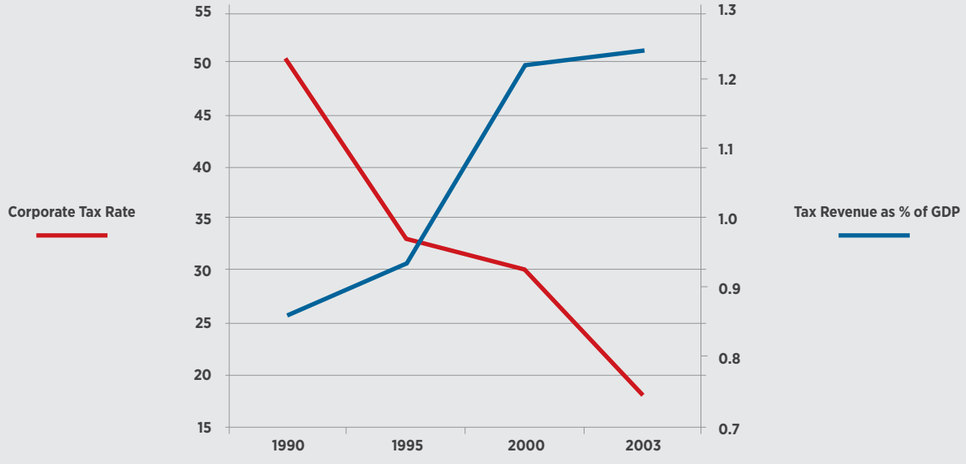
A possible response would be that when you are working for your taxes, you are working for the collective of which you are a voting member: You are therefore, as Rousseau would have said, working for yourself. But the premise of that argument is that the state is 'us', whereas it might appear to most people as being 'them'. Perhaps the model of the modern democratic state as a Leviathan is too pessimistic, although it has some predictive power. But the model of the state as a benevolent, enlightened and fully informed authority is surely too optimistic. The argument is not wholly false, however. If we are taxed in order to finance the production of a pure and perfect public good, such as defence, then 'we' are not only the contributors, but also the recipients of the transfer made, although the task remains to determine the quantity of public goods acceptable to almost all.

Another response is that Nozick's comparison to forced labour is wrong because people can control how much they contribute to the collective by more or less deciding, within the constraints of their circumstances, how much income they will earn. This argument, articulated by Buchanan, is not wrong.[303] But it highlights the problem with the redistributive programme: that the tax base is not fixed or immobile. Indeed people can, and will, decide how much income they will earn. In a high-tax society we could expect the preference for untaxed leisure over taxed work to grow, as I have said. But if Rawls' contention that individuals do not own their special talents, skills and expertise is accepted, then the next logical step might be to force them to do what they would not otherwise do. This was admitted by the British socialist and playwright George Bernard Shaw:

> But Weary Willie may say that he hates work, and is quite willing to take less, and be poor and dirty and ragged or even naked for the sake of getting off with less work. But that, as we have seen, cannot be allowed: voluntary poverty is just as mischievous socially as involuntary poverty: decent nations must insist on their citizens leading decent lives, doing their full share of the nation's work, and taking

FIGURE 9

LOWER TAX RATE BUT INCREASED REVENUE IN ICELAND



Source: Iceland Statistics and OECD.

300 Ibn Khaldun, *The Muqaddimah: An Introduction to History* [1377], Vols. I–III (Princeton NJ: Princeton University Press, 1958), p. 230

301 John Maynard Keynes, The Means to Prosperity [1933], *Essays in Persuasion, Collected Writings,* Vol. IX (Cambridge: Cambridge University Press, 1972), p. 338.

302 Nozick, *Anarchy,* p. 172.

303 James M. Buchanan, The Libertarian Legitimacy of the State, *Freedom in Constitutional Contract* (College Station TX: Texas A&M University Press, 1977), pp. 50–63. Repr. in *The Collected Works of James M. Buchanan,* Vol. 17 (Indianapolis IN: Liberty Fund, 2001), pp. 415–428.

> their full share of its income. ... Poverty and social irresponsibility will be forbidden luxuries. Compulsory social service is so unanswerably right that the very first duty of a government is to see that everybody works enough to pay her way and leave something over for the profit of the country and the improvement of the world.[304]

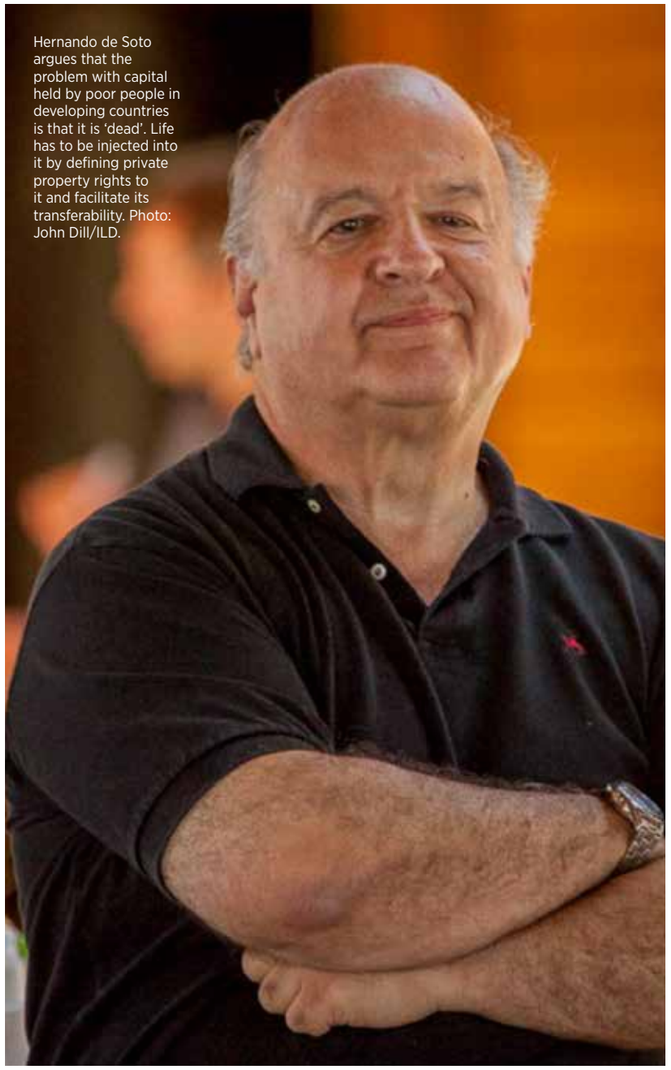
Shaw drew the logical conclusion when the principle of self-ownership is rejected. The obvious alternative is to regard people as serfs of society, conscripts in an army.

The new socialists have no interest in nationalising factories. They seek to nationalise people. This was anticipated long ago by de Tocqueville:

> After having thus successively taken each member of the community in its powerful grasp and fashioned him at will, the supreme power then extends its arm over the whole community. It covers the surface of society with a network of small complicated rules, minute and uniform, through which the most original minds and the most energetic characters cannot penetrate, to rise above the crowd. The will of man is not shattered, but softened, bent, and guided; men are seldom forced by it to act, but they are constantly restrained from acting. Such a power does not destroy, but it prevents existence; it does not tyrannize, but it compresses, enervates, extinguishes, and stupefies a people, till each nation is reduced to nothing better than a flock of timid and industrious animals, of which the government is the shepherd.

Tocqueville added: "I have always thought that servitude of the regular, quiet, and gentle kind which I have just described might be combined more easily than is commonly believed with some of the outward forms of freedom, and that it might even establish itself under the wing of the sovereignty of the people."[305]

The principle of Socialism in One Country, while necessary to stop the possible exodus of the most productive and richest groups in society, also means that the starkest inequality of our times is largely ignored by Rawls and Piketty: This is the inequality between those born in free and prosperous countries, such as the 10 provinces of Canada, the 50 states of the US or the 28 member states of the EU, and those from unfree and poor countries, in Africa, Latin America and Asia. The unfortunate people in less developed countries hardly enter into Rawls' and Piketty's deliberations. But while we may not be responsible for their poverty, we should worry about it. It is true that a few European countries on the Atlantic, Spain, Portugal, the United Kingdom, France,



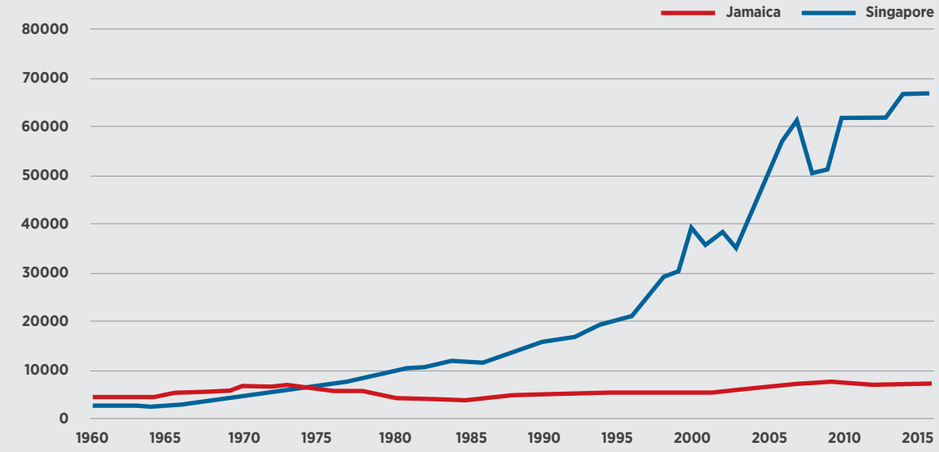
Hernando de Soto argues that the problem with capital held by poor people in developing countries is that it is 'dead'. Life has to be injected into it by defining private property rights to it and facilitate its transferability. Photo: John Dill/ILD.

304 George Bernard Shaw, *The Intelligent Woman's Guide to Socialism and Capitalism* (New York: Brentano's Publishers, 1928), pp. 72–73.

305 Tocqueville, *De la démocratie*, Vol. II, Bk. 4, Ch. 6.

FIGURE 10

THE WIDENING GAP BETWEEN SINGAPORE AND JAMAICA 1960–2016



Source: Maddison Project Database, version 2018 (online). Real GDP per capita in 2011 dollars.

the Netherlands and Belgium, took control of large colonies in the past and often behaved abominably towards their inhabitants, and, it should also be noted, sometimes honourably. But most colonies of the European powers were very poor before they were conquered: their poverty was not brought about by Europeans conquerors. The most affluent countries in Europe, Luxembourg, Switzerland, Norway and Iceland, never possessed any colonies, although Iceland was for centuries a tributary of the Norwegian king. It should give food for thought that the inhabitants of one of the last colonies in the world, Hong Kong, did not want to part with their British rulers.

We cannot be held responsible for poverty in the less developed countries because we did not cause it, although colonial rule may in some places have done more harm than good. Some might argue that nevertheless we have a duty to help the poor in the less developed countries. The argument is based on the undeniable premise that in life we have some non-voluntary obligations, for example to provide for our underage children and elderly parents, if indigent, and to defend our country. We have, the argument continues, a similar obligation to help people in distress: a captain cannot sail past a lifeboat full of people without at least trying to rescue them; if a child falls into a pond and is about to drown, then a passer-by is obliged to try and save it. It was wrong of the priest and the Levite to walk by the victim of the highwayman. If you could have saved lives by transferring resources to the starving in less developed countries, then you may become responsible for their death. You did not kill them, but you let them die.[306] This is however an unconvincing argument. It may apply to a sudden and unforeseen famine, but certainly not to the less developed countries as a whole over time. You can walk by a beggar, but you should not walk by a drowning child. These are different situations, one a reflection of a general condition, the other an emergency. Again, even if a moral duty of individuals would be established, it remains to justify its enforcement by government.

The distinction made here between a general condition and an emergency is reinforced by the fact that some former colonies have escaped poverty in a spectacular way. I have already mentioned Singapore and compared it with the other three Chinese economies in the world, Mainland China, Hong Kong and Taiwan. Another relevant comparison might be made between Singapore and Jamaica. Both are relatively small tropical islands which once were British colonies. Both had some endowments, Singapore an excellent location for an international port, Jamaica plentiful natural

306 Jan Narveson discusses and convincingly refutes such arguments, We Don't Owe them a Thing! *The Monist,* Vol. 86, No. 3 (2003), pp. 419–433; Is World Poverty a Moral Problem for the Wealthy? *The Journal of Ethics,* Vol. 8, No. 4 (2004), pp. 397–408.

The favela of Rocinha in Rio de Janeiro. Life has to be injected into the dead capital poor people hold, by defining private property rights and facilitating their exchange.

resources. Threatened by communist insurgencies, Singapore gained home rule in 1959. She joined Malaysia four years later, but was expelled and forced to become independent in 1965. Jamaica became independent in 1962. As late as 1960, she had a higher GDP per capita than Singapore. But the economy of Singapore grew rapidly and steadily over the next half century, and the city-state is now one of the richest countries in the world, whereas Jamaica has remained poor, with only sporadic growth.[307] In 2017, the average income per capita in Jamaica was only $5,100, ten times less than in Singapore.[308] This well illustrates that institutions matter, both law and culture. The economy of Singapore is one of the freest in the world, and her culture fosters family values, hard work and thriftiness, with great emphasis on education: It is as if her inhabitants have taken to heart Samuel Smiles' *Self-Help*. Jamaica, an old slave society, however lacks the strong traditions and social cohesion of Singapore. She also suffered from political instability, with a disastrous socialist government in the 1970s and 1980s.

The contrast between Singapore and Jamaica supports the explanation offered by Peruvian entrepreneur Hernando de Soto of why capitalism triumphs in the West and fails in many other places. Soto rejects the ideas often expressed that people in poor countries are less enterprising than in the West or somehow reluctant to embrace capitalism. People everywhere are motivated by self-interest in a wide sense, the desire to better the condition of themselves and their families. The main difference is that holdings of people in developing countries are often in what de Soto calls 'dead capital'. By this he means assets that are not properly defined and registered and cannot therefore be easily transferred or used as collateral. In many less developed countries, for example in Latin America and Africa, it is very difficult and costly to establish small businesses, while the state controls many resources. Potential entrepreneurs therefore face considerable hindrances and hurdles. In the West, on the other hand, secure and clear private property rights are usually taken for granted, and this injects life into capital.[309] In Singapore, entrepreneurship is encouraged, private property rights are well defined and the legal system runs smoothly. In Jamaica, on the other hand, a potential entrepreneur faces a rigid bureaucratic structure. It is estimated that the total cost of complying with all the tax laws in Jamaica amounts to more than one half of gross profits for such an entrepreneur. It is also very costly to register property: its cost is estimated to be equal to 13.5 per cent of the value of the property, whereas in the United States the ratio is 0.5 per cent. Jamaica has one of the least competitive economies in the world. Not unsurprisingly, from 1973 to 2007, the country experienced negative productivity growth.[310]

The reason why both Rawls and Piketty largely ignore poor countries is probably that there the task at hand is so obviously poverty alleviation rather than redistribution. It has become increasingly clear that Western countries cannot facilitate such poverty alleviation by so-called development aid, as mentioned in Chapter 3. Usually such 'aid' is a transfer from the treasury of an affluent country to the treasury of the poor country which may be poor because the ruling elite is corrupt, incompetent and intrusive. It may therefore have an effect opposite to what was intended. "Calling it aid does not make it so."[311] What Western countries however can and should do is to allow goods, services and capital to cross borders in both directions and to encourage competition in the marketplace. Piketty on the other hand says that "the question of liberalizing trade should no longer be the main focus. Trade must once again become a means in the service of higher ends." He argues against free trade agreements unless political conditions such as "fair taxation" are written into them.[312] In my opinion this shows a callous disregard for poor people in developing countries who desperately need free trade which, unlike the good government they also need, is in our gift.

Consider a factory which is moved from a high-income to a low-income country in order to save on labour costs and increase the profits of the owner. Critics of capitalism would see this as yet another instance of capitalist greed. But what is really happening is that workers in the low-income country suddenly get a new opportunity to better their condition. For them the move is much more important than it is for workers in the high-income country who already will have many other opportunities. The gain for the poor workers will be greater than the loss for the affluent ones. Perhaps in the short run, workers in the high-income country suffer a small loss: But then it is a spontaneous redistribution from the affluent to the poor. In the long run, the commodity produced in the factory will become cheaper as a result of the move, given competitive pressure, which means that the

307 Maddison Project Database, version 2018 (online). Jutta Bolt et al., Rebasing 'Maddison' (2018).

308 World Bank. GDP per capita, current US$ (online).

309 Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000).

310 Josh Lerner, *Boulevard of Broken Dreams Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed—and What to Do about It* (Princeton NJ: Princeton University Press, 2012), pp. 18–20.

311 Lomasky and Swan, Wealth, *Independent Review,* p. 507.

312 Thomas Piketty, We must rething globalization, or Trumpism will prevail, *The Guardian* 16 November 2016.

consumers, including workers in the high-income country, will gain. Of course the factory owner will profit, but after he has paid taxes on his profit, he is going to consume or invest the rest so it will re-enter the economy. Lord Bauer puts this point clearly: "I regard the extension of the range of choice, that is, an increase in the range of effective alternatives open to people, as the principle objective and criterion of economic development; and I judge a measure principally by its probable effects on the range of alternatives open to individuals."[313] This increase in the range of effective alternatives open to people is what has been happening in the developing world, slower in many places than was hoped, but also faster in some other places. Fortunately, Socialism in One Country has not yet been forced upon us.

313 Peter T. Bauer, *Economic Analysis and Policy in Underdeveloped Countries* (Durham NC: Duke University Press, 1957), p. 113.

11

CONCLUDING REMARKS

In a comparison between Napoleon Bonaparte and his cousin, Napoleon III, Karl Marx remarked that history repeats itself, first as tragedy, then as farce.[314] This seems to be true of socialism. The reign of socialists in Russia, Central and Eastern Europe, China and Southeast Asia was a tragedy on an immense scale, costing the lives of more than 100 million people,[315] and destroying the lives of several hundred million more who either languished in prisons or labour camps or lived in fear and squalor outside them. Finally the socialist bloc collapsed under its own weight, not being able to keep up with the West, as Ludwig von Mises as early as 1922 had predicted it would.[316] The remaining 'authentic' socialist countries, North Korea and Cuba, stand out as relics. But even if socialists have lost political power in most places, they still control most social science and humanities faculties in Western universities. Farce has replaced tragedy, as we observe the new 'Kathedersozialisten' heatedly discussing in countless university seminars how to spend other people's money. They inhabit echo chambers, moving in the rarified air of the academy, seemingly oblivious to the hustle and bustle outside. In my opinion, however, Hegel provided a subtler and better philosophical justification of the welfare state than either Rawls or Piketty, although he may have underestimated the self-corrective powers of a free civilisation. In the spirit of Hegel who always tried to elucidate the rational in the real,[317] we could perhaps say that in hindsight the welfare state was necessary to atone for past injustices in the initial acquisition of resources. But surely that goal has been achieved now in early twenty-first century. Moreover, another rationale for the welfare state, absolute poverty, is no longer a grave problem in the West, although relative poverty remains, as it always does, by definition.

The priest and the Levite who passed the wounded man on the way from Jerusalem to Jericho were the intellectuals of the time. The Good Samaritan was not. Modern intellectuals often look like Dickens' Mrs. Jellyby, who loved humanity rather than people. It is an extraordinary fact that most intellectuals support still socialism of one kind or another, although they call it liberalism in the United States. Many explanations have been offered for this bias. Austrian economist Joseph Schumpeter suggested that modern intellectuals lacked practical experience and therefore had not developed a sense of moderation and prudence. Indeed he feared that eventually they would go so far in undermining the free market order that they would destroy it.[318] French philosopher Bertrand de Jouvenel thought that intellectuals did not like consumer choice out of fear that they themselves would not be chosen instead of the businessmen ready to satisfy the often vulgar desires of ordinary people.[319] Friedrich von Hayek offered the somewhat kinder hypothesis that intellectuals tended to be rationalists fascinated by the possibility of recasting the whole of society in the image of one unifying idea, a blueprint.[320] Robert Nozick believed that intellectuals adopted the moral standards of the schools in which they usually excelled during their

314 Karl Marx, Der achtzehnte Brumaire des Louis Napoleon, *Die Revolution*, Erstes Heft (1852), repr. in Karl Marx and Friedrich Engels, *Werke,* Vol. 8 (Berlin: Dietz, 1960), p. 115. Victor Hugo called Napoleon III 'Napoleon le petit', Napoleon the little.

315 Stéphane Courtois et al., *The Black Book of Communism* (Cambridge MA: Harvard University Press, 1999).

316 Ludwig von Mises, *Die Gemeinwirtschaft* (Jena: Gustav Fischer, 1922).

317 Hegel, *Grundlinien,* Vorrede.

318 Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper & Brothers, 1942).

319 Bertrand de Jouvenel, The Treatment of Capitalism by Continental Intellectuals, *Capitalism and the Historians*, pp. 93–126.

320 Friedrich A. von Hayek, The Intellectuals and Socialism, *The University of Chicago Law Review,* Vol. 16, No. 3 (1949), pp. 417–433. Repr. in *The Collected Works of F. A. Hayek*, Vol. 10, *Socialism and War* (Indianapolis IN: Liberty Fund, 2009), pp. 221–238.

formative years and that they consequently resented the success in the marketplace of people less skilled with words, but with greater ability to make money.[321] There is probably something to all these explanations. But while we certainly should make a sustained effort to convince open-minded and thoughtful intellectuals of the arguments for the rule of law and free trade, as von Hayek suggested, we should not condone the use by socialist intellectuals of taxpayers' money in their campaign against these very same taxpayers. Society is not a suicide club, as British legal philosopher Herbert L. A. Hart once said.[322]

On the basis of the analysis offered in this report, some recommendations about policy can be made. Some of them may at present sound utopian, but we should recall that what is regarded as 'political impossible' greatly varies over time:

1. The welfare state has to be reformed without tearing apart an adequate safety net for the helpless. The most urgent reform in most Western countries is of the pension system which has to change from pay-as-you-go arrangements to fully funded pensions.

2. The pension age should also be raised: You should only be able to go on pension when you are 67 years or older, like in Iceland, and you should be able to work until you are 75 years, at least in certain professions where skills may actually increase with the year, or at least not decrease. People with experience, erudition and insight should not be excluded from the labour market.

3. Welfare should as much as possible become a local issue, on the subsidiary principle often invoked by the EU. Welfare benefits, where they are retained, should be means-tested so that rich parents would not receive child benefits or the high-income elderly publicly funded basic pensions. The authorities should target those in real need, not the middle class.

4. Unemployment benefits, when publicly funded, should not be so generous as to tempt people not to look for work. Unemployment, rampant amongst young people in Europe, should be reduced in the short term by greatly increasing flexibility in the labour market and in the long term by economic growth. It should be understood, though, that economic growth is less a goal for which the rulers can plan than the happy long-term outcome of sensible policies under sound institutions.

5. Inequalities, privileges and monopoly profits created by the state should be eliminated, which means that rules should be revised on patents, copyrights, trademarks, and occupational licensing, and that the tax system should be simplified and exemptions reduced, and that tariffs and other direct or indirect subsidies to producers, also in the arts and sports, should be abolished.

6. Even where there may be a political consensus that the state, or in other words usually the richest 20 per cent of the taxpayers, should pay for certain welfare services such as nursery schools and emergency wards, consumer choice and competition should wherever possible be introduced.

7. Compulsory primary education should aim at creating the skills necessary in the labour market, fostering a sense of national identity and encouraging and rewarding exceptional students.[323] It should be publicly funded, but with the possibility of choice and competition, for example through a voucher system.

8. Higher education should be privately produced, and paid for by its consumers, although the state might facilitate a sustainable system of student loans.

9. Medical services should be private produced, and paid for by its consumers, although the state might help to establish a system, even a compulsory one, of medical insurance.

10. Inequalities stemming from individual luck, personal skill and consumers' choice and not from any acts of injustice should be accepted, and those earning high income because of their superior talents, special skills and expertise should be applauded rather than envied. The Mozarts and Einsteins of this world bestow benefits upon us, even if the self-esteem of their possible rivals might be reduced.

321 Robert Nozick, Why Do Intellectuals Oppose Capitalism? *Policy Report*, Vol. 20 No. 1 (Washington DC: Cato Institute, 1998).

322 Herbert L. A. Hart, *The Concept of Law* (Oxford: Clarendon Press, 1961), p. 188.

323 I discuss national identity in two reports for New Direction, *In Defence of Small States* (Brussels: 2016) and *Why Conservatives Should Support the Free Market* (Brussels: 2018).

11. The welfare state should not be extended to financiers, banks and big corporations that regrettably are now often bailed out by governments. If depositors would get priority claims on banks' estates, like in Iceland, mass panic during financial crises could be avoided, and this should in turn make it possible to abolish government guarantees of deposits, although a private mutual insurance scheme of banks, like in Switzerland, may be established.

12. The state, or in other words usually the richest 20 per cent of the taxpayers, should not be forced to pay for socialist propaganda through government research grants or university courses, whereas of course socialists should be free to preach their creed at their own expense. The idea of science as the free competition of ideas should be encouraged.

13. Tax Freedom Day should be celebrated all over the world, marking the day when you start working for yourself and not for others. Perhaps in the calculation of the date the four widely accepted public goods, national defence, public security, a safety net and primary education, should be subtracted from total government outlays as being legitimate and benefitting all. This would shorten the period in which you are presumed to work for others. If so, then the End of Forced Labour Day might be celebrated which would be at the end of the period when you are only working for others, and not for yourself, individually and collectively.

14. The OECD, once a bulwark of free market economics, should cease to advocate collectivism, redistributionism and 'tax harmonisation' and focus instead on collecting data and enlightening the public about fundamental economic principles.

15. The EU should cease to put pressure on its member states to raise their corporate income taxes and instead allow them to set the level of taxation themselves. The EU should be developed in the direction of an open market, not of a closed state. It should be a federation of states, not a federal state. It should be more like a market forum than a fortress.

16. The World Bank and the IMF should cease to extend soft loans to governments that cannot obtain them on the free market because they are correctly deemed too risky. Such loans only encourage public profligacy. Instead these organisations should focus on enhancing the understanding by politicians and the public alike of fundamental economic principles.

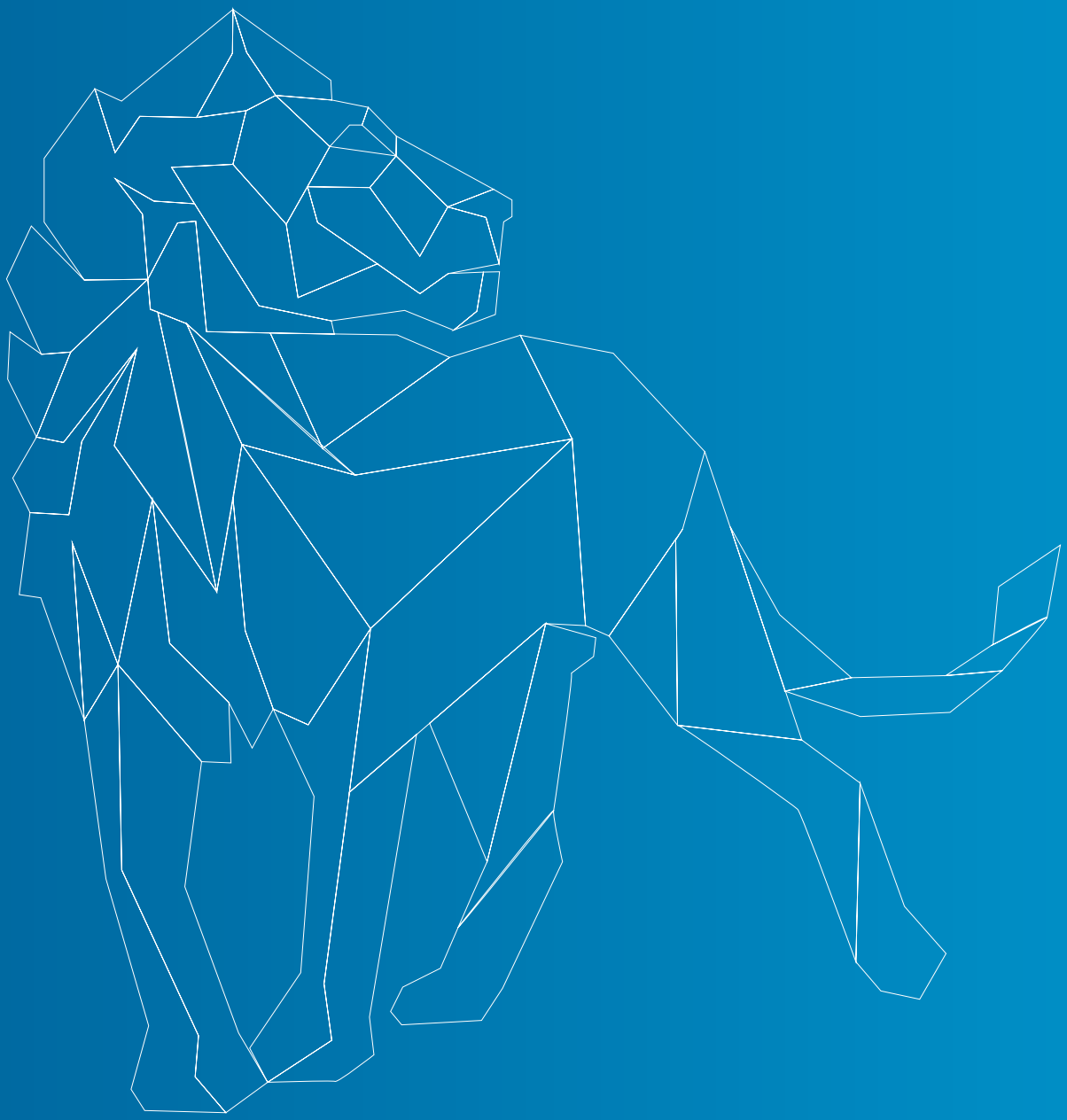
17. So-called development aid should be abolished, or radically reduced. The only effective aid is that given directly to designated recipients and monitored by concerned individuals and private organisations and foundations, such as the Bill and Melinda Gates Foundation. Of course, emergency aid should be maintained.

18. The only effective long-term aid by governments in affluent Western countries to less developed countries is free trade. Capital should also be allowed to flow freely across borders, and immigration should only be restricted by considerations of integration (some groups refuse to accept the moral codes and social practices of Western countries), political unrest and the capacities of the welfare state (some groups seem solely to seek welfare benefits, while others are eager to work hard and contribute).

19. The progressive personal income tax should be made a flat tax, with a low tax-free level. In an inclusive society, almost everybody should be included in the group of taxpayers, even if some of them may only contribute small amounts. Already many countries in Central and Eastern Europe have adopted a flat income tax, as well as the Channel Islands.

20. The wealth tax and all capital gains taxes should be abolished. This would mean more money at the disposal of people with high to middle income which could imply a great increase in private charity, or alternatively a growing demand for the goods and services of low-income groups. Already many European countries have abolished the wealth tax, including Sweden, Denmark, Finland, Iceland, Germany, Austria and Germany.

21. The inheritance tax should be abolished. It is particularly pernicious, as it usually taxes the same income for the third time, after it has been taxed as income and then the remainder as capital. Indeed, it has been abolished in many European countries, including Sweden, Norway, Austria, Portugal, Slovakia and Hungary.



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