

The Economics of Wealth and Poverty

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1 Introduction

During most of the last 40 years, redistribution of income and wealth has been a major activity of governments. It has also been a major subject of discussion among economists, but the amount of formal analysis has been limited. Further, what analysis there was, was very largely an effort to determine how equally income was distributed both before and after the redistribution.

In addition to this, the rather traditional economic field of income distribution, of course, continued active. In fact, it expanded considerably due to the realisation that human capital was an important variable, and hence, there were studies of the return on human capital and its effect on the distribution of income. Sometimes these studies were carried on in the context of income redistribution.

Nevertheless, there was relatively little work on the economics of redistribution itself. My point in discussing this approach by other economists is, more or less, to excuse the fact that I too did very little during most of this time on income redistribution. Like other economists, I was interested in the subject but tended to think it essentially a matter of morals or values which could not be analysed. I, of course, still think that the ultimate decision on the amount of equalisation is a matter of individual values, but I now think that, nevertheless, a good deal of research can be done. As I have now produced a book on the subject,¹ it seemed timely to put together what I had previously written in the field of income redistribution and related topics. Hence, this book. I am happy to say that none of these papers deals with efforts to measure the degree of equality in society before or after redistribution, although there are some references to measures made by other people.

Perhaps I should, however, begin by making a few remarks about my own value situation. Basically, I started out with, I think, the standard view. That is, I thought that we should help the poor. I had no determinate idea as to how much we should help them, but would have been willing to say that particular payments were too much or too little. I now realise, of course, that these judgements, like most value judgements in this area, were perfectly arbitrary, but I don't think that when I was in college studying law I was aware of this.

At that time, I don't think that I had any feeling at all about whether help to the poor should be done by government or private charity. Later, I came for a time to think that it should be mainly dealt with by private charity, but I was cured of that by Milton Friedman, of all people.

This rather normal, badly thought-out set of values is, I think, standard in this field. In my case it received a very severe blow when I joined the foreign service and went to China and later Korea. I immediately found myself in very poor countries which were both made even poorer than usual because of war. I was surrounded by people who, literally, were on the verge of starvation. Further, in China one saw on the streets people with various conditions which obviously required medical treatment. They weren't being treated because they couldn't afford it. There were also in China a certain number of professional beggars, who had been deliberately crippled as small children by their parents, in order to increase their appeal as beggars. The number of the latter was quite small because since the overthrow of the Manchu Dynasty in 1911, crippling of this sort had been illegal. The enforcement of these laws had been made difficult by the continuing civil war but, nevertheless, this phenomenon which used to be very common in China had become a rarity. But there is a difference between being a rarity and not being there at all.

Granted the sort of standard American values which I have described above (i.e. we should help the poor but without any clear idea of how much) this was a rather shocking situation. It was perfectly obvious that my income, if I chose to redistribute it, dropping myself to, let us say, an average Chinese income (at the time, that would have been about the average world income) would have permitted me in almost any year to save from starvation something in the order of 50 to 60 human beings. This would, of course, have involved a sharp reduction in my own living standard, but it is very hard to argue that I, in any real sense, deserved a higher income than the world average. Of course, my superiors in the foreign service would have probably had me shipped home as mentally unstable if I had made such a redistribution. Nevertheless, the problem was a real one, and one which I found quite disturbing.

To give but one extreme case, I was in Seoul immediately after the war, at a time of very great poverty. Outside the window of my office in the American embassy there were the ruins of what, I take it, had been a house. In any event, the ruins consisted primarily simply of a fireplace and a little bit of chimney. A gang of about eight or nine street boys had made this into their 'house'. Specifically, at night they would sleep huddled together into the fireplace. Obviously, only one or two of them could actually get into the fireplace, even though they were quite small, but by clumping with the fireplace on one side it was possible to keep warmer at night.

I was, at the time, living in a small, dilapidated government furnished house, but it was obvious that if I had invited them into my house and given them, let us say, one half of it, they would have been massively better off yet still much worse off than me. Needless to say, again, this would have led to my being shipped back to the United States. I could, however, think of no

objective reason why I deserved the difference in our income. Further, even if I did deserve the difference in our income, standard moral principles would have implied that I should have made large gifts to them.

Another aspect of the problem, which I found at the time surprising, was that an awful lot of these people were cheerful. This street gang, which I never had any personal contact with, used to get little bits of wood and cook something for their breakfast every morning. I presume it was not very good food, but I was looking down from the third floor and couldn't make any close examination. On several occasions I watched them having their breakfast, and they were clearly quite cheerful and happy about the whole thing. Further, in China itself I discovered that, on the whole, the Chinese seemed to be reasonably happy. This would have given me a very strong feeling that money does not bring happiness, were it not for the fact that, of course, money at least gave me a standard of medical care that they did not have, and illness is positively painful. Still, the ability of human beings to make the best of a bad deal was quite impressive.

I should say that I now feel that these observations about their happiness are, to a considerable extent, deceptive. The 'Reduction of Cognitive Dissonance', discussed further below (Chapter 3) leads people frequently to underplay their own problems. All of these people would have much preferred the kind of food, housing, clothing, medical care, etc. that I had, although whether they would have laughed louder at jokes in my social environment than in their own social environment is dubious. As a matter of fact, the Chinese have, over the centuries, rather specialised in those two cheapest of all 'luxuries', good manners and an elaborate social life. No doubt they get a great deal of satisfaction out of them. They would get more satisfaction out of them, however, if their real resources were greater.

As I said, all of this bothered me. Obviously, inspecting my own preference function, I was not willing to impoverish myself in order to prevent a lot of real suffering and death among a number of other people. That would have been true even if the Department of State would not have shipped me home if I had. The problem was made somewhat more severe by the fact that actually giving people money, whether to beggars on the streets or a more regular pension arrangement, was positively dangerous. For example, suppose I had decided to help this small group of boys by taking them into my home and providing them with food, it would have been dangerous because, in essence, the demand was infinite. I would immediately have found myself deluged by other people with equally good claims who would want my aid also. It was decidedly unpleasant to be known to beggars in either China or in Korea as a person who made gifts to them. I discovered this the hard way, and after the first month or so, never gave anything to any street beggars.

Another problem here was that most of my colleagues didn't seem to be

bothered by the matter. In general, their political position was well to the left of mine, and they were in favour of equality, and so on, but they didn't seem to find the fact that their income was so very much higher than that of the Chinese or Koreans indicated that they should do anything. They were, on the whole, content to live that way, perhaps to make small contributions to various local charities which could offer a reasonable guarantee that you would not, as a result of the gift, be deluged by people waiting outside your door to demand money as soon as you came out.

Indeed, in many cases, these people seemed to develop an antagonism against the poor of the native population. Rather than feeling sorry for them, they felt irritated and would actually make remarks as if their poverty was, in some way, a reflection on the people themselves. This is particularly true of those of my friends, particularly wives of the foreign service officers, who did occasionally make gifts to beggars on the street. As a result of these gifts, they found themselves continuously having to fight off eager solicitors for more money. This, quite reasonably, irritated them and they tended to express their irritation in terms of criticism of the beggars. I, myself, found the matter annoying and stopped making gifts to beggars. I never, however, felt that the beggars were other than very unfortunate people who were doing their best in a terrible situation.

All of this led me to a good deal of thought and effort to reconsider my own value preferences. I came to realise something that I think most people do not realise, and that is that although I was in favour of giving money to the poor, I didn't want to give very much to them, and the basic reason I didn't want to give very much to them was very simple. I wanted to spend the money myself. In other words, my preference function (this was before I knew much economics) put much more weight on my consumption than it did on the consumption of the poor, although it did not give zero weight to the consumption of the poor. In essence, I realised that all of my life I had been saying things about helping the poor which were not really in accord with my preferences.

I should say that, as far as I know, this reaction on my part to the problem was unique. Most of the people continued being, let us say, mildly socialist and in favour of equality, while neither wanting themselves to give money to the Chinese population to the point where there was something even remotely close to equality between their own income and the Chinese, or wanting the American government to do so. My realisation that there was substantially nobody in the United States who was poor by world standards was an unusual evaluation of the situation. Most people continued making statements about the desirability of equality and helping the poor, and in fact, making only rather modest sacrifices to that end. They were also in favour of their government making only rather modest gifts to the poor.

This problem continued to bother me, both when I was in the foreign service and later. I observed, for example, that the American government was, by international standards, quite generous in making gifts to the poor parts of the world. These gifts, however, were very modest if you compared them with the amount that the American people could have given, or the amount that would be necessary if any serious thought had been given to the objective of equalising income between all human beings. They were also quite modest if you compared them with what the American government gave to American poor, who already had much higher living standards than the peoples of India or Africa. Further, inspecting on my own preference function, I found that I was not particularly opposed to the American government's programme. Indeed, I tended to be rather opposed to our foreign aid programme, but that was, essentially, not because I objected to giving money to foreigners, but because of the extremely inept way in which the money was normally dispersed.

Nevertheless, it was clear to me that what we were doing, if it was in accord with the popular preference and in accord with my own preference, more or less, was radically different from the official rationalisations used for it. Although our slogans imply that we should regard any human being as good as another, our practice is intensely nationalistic.

Further, if we look at the transfers in the United States, we find that the bulk of them do not go to the poor. But that is a matter which will be dealt with further below. Nor is this, in any sense, a special characteristic of Americans. The European welfare states in practice normally make a greater distinction between foreigners and their own citizens than we do. This is particularly remarkable because some of them, through guest-worker policies, have a number of foreigners actually working inside their country. With the notable exception of West Germany, these exploited foreigners do not have anywhere near the same welfare privileges as the citizens. Indeed, the treatment of the Turks in Zurich is very similar to the treatment of blacks in Johannesburg. This does not, of course, prevent the Swiss from being very critical of the South African government.

After I ceased to be a foreign service officer and became an economist, my primary work did not involve this particular problem. Nevertheless, I continued reading quite extensively about international matters and, hence, a radical distinction between the way the welfare state treats its own citizens and the way it treats impoverished foreigners was always in the front of my mind.

I kept thinking about the general problem during most of this period, but to no great consequence. There was a period during this time when I came to the conclusion that charity, on the whole, should be removed from the agenda of government activity and be private. I changed my mind about this partly because of the rather technical problem which is discussed in my

first article on the subject, 'Information Without Profit'.² More importantly, however, I had the good fortune to be at the conference at Wabash College in which Milton Friedman read the lectures which eventually became his book *Capitalism and Freedom*.³ In that book, he presents a valid economic argument for government provision of aid to the poor and downtrodden. The argument I found convincing and, ever since then, I have been in favour of government aid to the poor.

As I began learning more about the subject, however, I began to have doubts as to whether the government of the United States, or for that matter, the other welfare states, were actually much interested in the poor. 'The Charity of the Uncharitable' (Chapter 3) looks into some of the reasons why I began having doubts of a theoretical nature.

In the late 1970s, I became more interested in the economics of helping the poor and I also, by that time, had begun to have more definite ideas about it. These more definite ideas led both to a number of papers, some published and some not, and my book, mentioned above. What basically happened here is that I came to the conclusion that the personal preferences which I had found in myself as a result of examining my own behaviour in the Orient are, in fact, the personal preferences of most people. The reason that the Americans do not spend a larger part of their national income to help the very poor in other parts of the world is simply that they want to spend the money on themselves. They are charitable, but not very. By a rough rule of thumb, people are willing to give away up to 5 per cent of their own income to help others not in their family, but not more.

There are, of course, occasional saints who will, literally, impoverish themselves to help others. There are, also, occasional people who are so self-centred that they don't give away any money or other resources at all. The government system, like private charity, must adjust itself to the preferences of the people and, hence, does give relatively little to the poor, but does not give nothing to them.

The bulk of income redistribution tends to be back and forth within the middle class in terms of political organisation. In other words, it is given to people who want it, and have the political power to get it. Thus, redistribution is sometimes rationalised on the grounds that it helps the poor,⁴ but basically, it is people making use of the government to improve their own wealth. The motives are selfish, not charitable. It is an example of rent-seeking, and I've included in this book one paper on this (Chapter 8).

I cannot blame people who behave this way. It is a perfectly ordinary pattern of behaviour. Still, one of the major points of this book is that that is what we do. We are not as charitable as we would like to think we are.

In general, my position on redistribution is unorthodox. The lack of orthodoxy, however, interestingly, refers only to what is said about redistribution, not to what is done. There is a vast literature in the field, but

almost all of it implies that we should be giving far more money to the poor than we are. Almost all of it totally ignores our tendency to redistribute large amounts of money to well-organised groups, such as the farmers, the Gray Panthers, and the like. In practice, although we do indeed give funds to the poor, particularly to the American poor, we give far more to well-organised pressure groups.

Turning to the actual content of the book, Part I is devoted to our reasons for the policies we now follow. It fits into the general literature here in that it points out that our behaviour is frequently not in accord with our professions. It differs sharply from this literature in that it is not an argument that we should change our behaviour. Further, I suggest that we should change our language because I believe that our behaviour more accurately represents our actual feelings than what we say does. This is more or less the reverse of the usual approach. Amartya Sen⁵ presents a new and radical interpretation of famines. He argues—and there is no doubt he is right in at least some cases—that the problem in famine is not a shortage of food, but a shortage of purchasing power. There is plenty of food, but the poor can't afford to buy it. From this he deduces that we should make certain that they can afford to buy the food in bad times. This is a very superior example of what I might call the normal approach. The difference between our moral aspirations and our actual activity is pointed out and it is urged that we do something about it. Note that in this, as in most such cases, the actual reform proposed is rather modest since the cost of providing food in famines would be a mere trifle in the American budget.

My approach, if I had been writing the book, might have been the same on facts, but my evaluation would have been different. I would have pointed out that what we claimed were our principles were not the principles we were working on and simply left it at that. I would not have delivered a moral lecture. Indeed, in at least one of the cases he discusses, the Bengal famine during 1943, I believe was deliberately induced by the imperial government of India for essentially political reasons. Personally, I find this kind of political activity extremely distasteful, but I try to avoid imposing my own values on the reader in this matter.

In a way, my position is much more radical than Sen's. His falls into the general tradition of analysis of poverty combined with a moral lecture. I avoid the moral lecture. If the reader feels strongly about these matters, he is free to use his own value system to evaluate them.

In any event, the first three chapters, simply look into our practice and the probable real motives behind it. Chapter 3, 'The Charity of the Uncharitable', was published some time ago and indeed has been republished twice since then. Chapter 1, 'Reasons for Redistribution', was published in a somewhat reduced and shortened form as my Presidential address to the Southern Economic Association; Chapter 2, 'The Objectives

of Redistribution', was prepared for a private conference and has never been published before. The three, in a way, set the tone of the book and indicate fairly clearly the difference between my point of view and that held by most students in the field.

Part II deals with some problems in the organisation of aid to the poor and downtrodden. Chapter 4, 'Information Without Profit', has been reprinted in several places and deals with, quite literally, the extreme information problems that any charitable organisation, private or public, faces. Most discussions in this area tend to overlook these information problems, although no one has raised any questions about the accuracy of my analysis.

This particular article has a somewhat interesting history. The journal, *Public Choice*, started out as a single-issue collection of papers which were then circulating through the invisible academy, but which were difficult to publish because of their subject-matter. It was a personal entrepreneurial activity with my original plans being that I would pay for it out of my own pocket.⁶ Under the circumstances, I could put anything I wanted in it. All of the articles except this one are in the field we now call public choice. Since I wanted to put this one in however, I could hardly give the book a name which confined it to analysis of the political system. Thus, the not very attractive name, 'Papers on Non-Market Decision-Making', was chosen and when it was discovered that it would be possible to convert this single publication into a series, that name was retained for the two succeeding issues.

At this time, various names were being canvassed for this new discipline, which involves a combination of economics and politics. For example, 'Polonomics' or 'Synergistics'. As a result of my choosing 'Papers on Non-Market Decision-Making', the actual decision was put off for a couple of years and then the name 'Public Choice' chosen. My selection of a particularly bad title gave us the opportunity to have a better title in the future.

The rest of Part II comprises an article that I published, together with Browning's criticism and my reply. I believe it was revolutionary in its time, although now of course it looks orthodox. Economists had, for a long period of time, thought that transfers were essentially a costless activity because the welfare triangles were obviously small. The debate changed the orthodoxy, although to this day, we do not have accurate measures of the actual costs. They are in any event bigger than the welfare triangles.

Part III contains two previously unpublished papers both of which offer suggestions for technical improvements in the way that we redistribute income. The last, Chapter 10 'Demand Revealing, Transfers, and Rent Seeking', was written for this book and demonstrates that the demand-revealing process can be used for income transfers without excessive cost. It

also provides an analysis of cases in which we would rather that the income transfer did not occur, such as payments to well-organised pressure groups, and demonstrates that they would be much harder with demand revealing than they are under present circumstances. Since demand revealing would be, to put the matter mildly, a radical change in our present circumstances, it may seem that it is not worth the trouble discussing it. Nevertheless, radical changes have occurred in the past, and if this is an improvement, we should at least think about it.

Chapter 8, 'Local Redistribution', deals with a problem in which the orthodox opinion is almost certainly wrong, the error of which has already been pointed out by earlier writers. Since the previous work of Pauly and Buchanan,⁷ however, has been very largely ignored, it seemed worthwhile presenting it again in forceful language. The original contribution of this particular article is the discussion of concrete institutional structures which would make it possible for the theoretical suggestions of Pauly and Buchanan to be carried out.

'Aid in Kind' (Chapter 9) is simply a technical investigation of the rather common tendency of welfare states to make some of their aid to the poor in the form of such things as free medical care or subsidised housing. In this respect, it is a step forward from the existing literature but mainly in a technical sense. There are no radical proposals for change although, like substantially all economists, I prefer payments in cash to payments in kind.

Part IV deals with a number of specific technical problems in redistribution. In each case, my position is different from the current orthodoxy, but also in each case, I believe that the problem with the current orthodoxy has been a tendency to permit emotions to overcome logic. Indeed, it is not that the defenders of the orthodox position make logical errors, they simply pay no attention to some of the basic problems.

Chapter 11, on public defenders, is a clear-cut example. I have been unable to find anywhere in the very extensive legal and political literature on public defenders any solution to the problems that I raise. People who actually administer the provision of free legal aid to the poor must be reaching practical solutions, but there is no evidence that there is a formal decision on the matter or that different agencies reach the same practical solution.

Chapter 12 deals with an area where there has been immense discussion. Calabresi and Bobbitt, when they wrote their book *Tragic Choices*, set off a major outburst of interest in the problem. My paper reproduced here was originally a review in the *New York University Law Review*,⁸ of that book with, of course, reference to the discussion to which it had given rise. If I am correct—and Calabresi more or less confirmed this to me in private correspondence—the basic problem here is that we, as basically charitable citizens, do not like to think about situations in which

we permit people to die simply because the amount which we would need to spend on keeping them alive is too great.

This leads to the adoption of organisational structures, the basic purpose of which is to conceal from us the decision we are in fact making. Obviously, we cannot make decisions about these institutions either, because that would raise the same kind of mental tension. But having raised this problem, I regret to say, I have no solution for it. Perhaps some of the readers can do better than I have.

There has been very little discussion of inheritance in the technical economic literature. In spite of this, most peoples tend to feel that inherited wealth is undesirable and confiscatory taxes justifiable. Chapter 13, 'Inheritance Justified' challenged this view and immediately set off quite an active discussion. I think, technically, the argument that confiscatory taxation injures some people and benefits no one is invulnerable. There are, of course, many people who feel that there are overriding social values which require limitations on inheritance. My argument here will be thought irrelevant by them.

Part V deals with two conditions which may lead to poverty. Chapter 14, 'Population Paradoxes', is the only paper in this volume which I made a serious, but unsuccessful effort to have published. I would say that the reason it was not published is that the paradoxes pained the population experts to whom the work was sent. The readers may feel that they were right and I was wrong, but in any event, that is my opinion. If I am correct the paper raises a very serious problem which the standard literature on population has simply ignored.

The final chapter is a rather unusual thing to come from someone from the University of Chicago. It argues that, to some extent, the market lacks a stabilising mechanism. Thus, we can expect depressions and booms together with sharp fluctuations in specialised markets. When I was a small child, I visited Florida immediately following the collapse of the great Florida boom of the 1920s and I saw many examples of a macro fluctuation which had not been stabilised by the market.

There is a distinct resemblance to the work of Leijonhufvud and that of Clower. It differs mainly in pointing to a specific mechanism and in arguing that there are many cases in which the macro failure is not one of the whole economy going up and down more than it should, but of some special segment of it, like the Florida land prices in the 1920s, deviating from their long-run pattern.

The book as a whole superficially seems to be a fairly severe criticism of our present practice in the field of charity. Actually, I do not intend to criticise our practice, but our theoretical discussions of it. As an economist, I think that what people want is better represented by what they do than by what they say. In the field of redistribution, there is a vast gap between what

people say and what they do. I would suggest that this gap be closed, not by changing our actions, but by changing what we say. Let us frankly admit that we are only moderately charitable, and that we are quite nationalistic. Let us further frankly admit that our political system and, indeed, all known political systems are susceptible to rent seeking, with the result that they engage in a lot of income transfers for which the only argument is that the recipients want the money. This may not be a very encouraging point of view, but at least it is beginning from which we can do valid research. If we want to improve our situation, we must begin by recognising what the situation is.

NOTES

1. *Economics of Income Redistribution* (Hingham, Mass. Kluwer-Nijhoff, 1983). There is a sort of condensation of this book, *Welfare for the Well to Do* (The Fisher Institute, 1983).
2. See 'Information Without Profit', Chapter 4, below.
3. *Capitalism and Freedom*, Milton Friedman (Chicago: The University of Chicago Press, 1962).
4. Benjamin Franklin once said, 'What a help it is to be a reasoning being, because it permits us to rationalise anything we wish to do.'
5. Amartya Sen, *Poverty and Famines: An Essay on Entitlement and Deprivation* (New York: Oxford University Press, 1981).
6. A small foundation grant came in at the last minute with the result that I did not have to do so.
7. Mark Pauly, 'Income Distribution as a Local Public Good', *Journal of Public Economics*, vol. 2 (February 1973), pp. 35-58. James M. Buchanan, 'Who Should Distribute What in a Federal System?', in *Redistribution Through Public Choice*, ed. H. Hochman and G. Peterson (New York: Columbia, 1974).
8. 'Avoiding Difficult Decisions', a review article of *Tragic Choices*, by Guido Calabresi and Philip Bobbitt. In the *New York University Law Review*, vol. 54, no. 1 (April 1979), pp. 267-79.

