A Moderate Compromise: Economic Policy Choice in an Era of Globalization
(Excerpt) - by Steve Suranovic (Palgrave McMillan, 2010)

Chapter 10 – A New Guide to Policy Choice in an Era of Globalization

One of the most important questions in economics and politics is what sort of laws, institutions, and policies a society should implement. A country's Constitution defines the basic rules and procedures determining how a country will be governed and what rights and privileges its citizens will enjoy. Each country's legislature establishes rules, regulations and laws that its citizens must follow. Within each country's Constitution a process is defined for changing these laws. Government policy is concerned with the following question: what is the best set of rules and laws for a country to implement? One thing seems clear from the political debates and the continual discussion about how policies ought to be further changed and adjusted; nations have still not reached any sort of "policy equilibrium."

How we choose policies is critically important for everyone. It will determine how rapidly incomes will grow, how many people continue to live in poverty fifty years from now, whether children in the next generation will do better and live happier than their parents' generation, what freedoms and privileges people will enjoy and what constraints they will face.

The current method of economic policy choice appears to be terribly ineffective. For example, in the debate over trade policy and globalization issues, very little has changed in the past 25, 50 and even 100 years. Despite some dramatic movements towards trade liberalization in the past half-century, economic arguments supporting free trade and globalization are presently being strongly countered with interventionist prescriptions by new groups suspicious of the previous trends. In addition, while the debate rages on and with accumulating new evidence supporting one side or the other, the weaknesses of the current analytical methods used to assess policy have been quietly muffled. The reasons for the persistent impasse and for the obscuration are manifold.

One reason is that any policy change whatsoever, will have both positive and negative effects both nationally and internationally. These impacts, by themselves, simultaneously assure both support and opposition to any policy proposal. The economic solution of compensation to offset the expected losses is impractical as discussed in Chapters 2 and 3; first because it is impossible to accurately identify who gains and who loses how much, and second because there is no way of knowing whether the gains from any prescribed policy change will exceed the losses.

The fact that positive effects from policies like trade liberalization, is possible theoretically, and empirically demonstrable, is not sufficient to prove that these policy options are best in some overall sense. This is because it is always possible to provide theoretical and empirical support for the opposing policies. Although different sides to the debate will contend that their investigative methods are superior to their opposition's, a more objective observer should conclude that neither side's methods come anywhere close to answering the questions we need to answer; namely, which policy is most efficient (using a *broadly defined* measure of well-being), who are the likely winners and losers, and can we implement a compensation scheme to assure all will benefit?

Another issue exacerbates the problem: although we cannot realistically identify all the winners and losers from policy changes, some groups will recognize that they would either gain or lose from any proposed policy change. These groups have the incentive to promote or protect their own interests. Often this leads to new policy proposals; proposals that immediately inspire opposition by other groups who recognize they are likely to lose if that policy is implemented. What ensues is a rhetorical battle as each side tries to accumulate as much information supporting their cause and present it to all the other participants in the policy decision; sometimes there are appeals to voters, sometimes to members of a legislature. Thus, there is always a demand for information attesting to the positive and negative impacts of every policy, even though as argued here, that information is incapable of indicating whether the policy choice is good or bad from an overall perspective.

The result is numerous policies that tend to favor some groups at the expense of others. The groups more likely to win are those who can most effectively exert influence within the process. The winning groups will sometimes be those with more money to spend on a campaign to bolster support, sometimes the groups will be ones who have personal connections to a large network of decision makers, sometimes groups will win because they transfer or bribe enough people to support their cause, and finally sometimes groups will win because they have disseminated information effectively enough to convince a sufficient number of people to choose their preferred policy.

Unfortunately though, this sort of decision procedure is unlikely to lead to policies that are ideal in any overall sense, except by sheer luck. We can never measure the outcomes adequately enough to know for sure. Instead the process will lead to continual policy changes and adjustments driven largely by changes in the ability of different groups to influence others over time. In other words, as some groups become more influential, their policies will be adopted while the policies preferred by groups with falling influence will be overturned. This approach leads nowhere, except around and around in circles.

An alternative approach to policy evaluation is to consider whether a policy is fair or just. However, here too, the choice criteria are incapable of providing a definitive guide to policy. That's because there are at least seven distinct fairness conceptions that evaluators can choose from and these principles contradict each other when used to evaluate particular policy choices. Given the added problems that each fairness conception can be applied either narrowly or broadly, and that different variables can be chosen for the fairness evaluation and we get a situation where virtually any policy can be considered fair. By picking the appropriate fairness conception and its application, a policy can be reasonably deemed fair by one group but simultaneously argued to be unfair by another group.

A New Way Forward

Of course, unless or until we conceive of a viable alternative, it is impossible to change the way we evaluate policies. For any alternative to be broadly acceptable, it must recognize the concerns on all sides. Any alternative must also be relatively simple to understand and implement: complex ideas have little chance of appealing to a mass audience.

The policy proposal in this book suggests a new way forward by applying a simple heuristic mechanism for policy choice. The mechanism represents a moderate compromise between what are often seen as the two extremes in policy options; namely policies promoting a free market versus policies promoting social justice and fairness. The compromise mechanism has the potential to garner broad support among a diverse group of people because it identifies a single root cause of concern shared by observers on opposite sides of the policy spectrum. Although the mechanism described here will be described primarily with reference to globalization policies, the compromise mechanism is general enough to apply to all public policy decisions.

Simply stated, the mechanism involves choosing policies, procedures and institutions in light of three basic principles, which individually and together serve to promote five goals:

A) For Efficiency: Enable and promote mutually voluntary exchanges

B) For Security: Discourage, restrict, or prohibit involuntary transfers

C) For Compassion: Enable, and encourage, voluntary transfers

D) For Freedom: promote voluntary actions but prevent involuntary actions.

E) For Justice: adhere to all three principles simultaneously

Efficiency

Economic efficiency is achieved by allowing and promoting voluntary exchanges whenever, wherever, and with whomever, people wish to make them. Voluntary exchange generates surplus value that benefits both parties in every exchange, thus because of trade something less becomes something more. That is the definition of rising efficiency; creating something more out of less. Voluntary exchange is also necessary to take advantage of the division of labor, which enables greater individual output (economies of scale) via specialization. Without free voluntary exchange (i.e. trade) afterwards, specialization has no value.

It is not an exaggeration to say that the source of the world's prosperity, the reason for the dramatic increase in so many people's standards of living in recent human history is the enormous expansion of the division of labor and the voluntary exchanges that sustain it.

Efficiency is promoted in another way too. Billions of voluntary trades occurring together in a market represents the operation of a free market competitive economy. Competition arises because in a market with thousands or millions or billions of trades, many people will be offering to sell similar products. Buyers will have more than one seller to choose from. As a result sellers will win the competition against other sellers only by offering a product that is more desirable to the consumer. In other words, the "competitive market" creates an *incentive* to satisfy consumer desires and demands. This is the ultimate goal of an economic system. The greater the competition, the greater these incentives and the greater the potential surplus generated out of the process. Thus, a competitive market promotes the incentives that result in greater economic efficiency.

Security

Security is achieved by discouraging, restricting or prohibiting involuntary transfers. Complete and total security is impossible since, in the presence of a surplus, and when individuals store that surplus in the form of property and goods, theft will always be a possible method to profit for some people. In addition, violence, one person against another, or one country against another, seems unlikely to disappear anytime soon. For these reasons, defense of one's person and property is necessary.

In one sense, defense is a wasteful activity since all resources devoted to protection are unavailable to produce other directly useful goods and services. In a perfect world individuals would not need locks and safes and guns for security;

businesses would not need security guards; communities would not need a police force; and countries would not need a standing army. If all of those resources were devoted to producing food, clothing, movies and vacations, a substantially greater amount of goods and services would be available. However, because involuntary transfers in the form of theft and violence are ever present, we do need to prevent it as best we can. Defense is an unfortunate necessity.

Government can play a role in providing for a community's and a nation's defense. Most important are laws prohibiting personal violence and property theft and punishments for those found guilty of these transgressions. However, involuntary transfers occur in many more diverse ways than just theft and violence. They also occur if workers are exploited and mistreated, when people take bribes, when people lie or cheat to gain an advantage over others, and even when government policy is used to restrict competition and give some groups advantages over others. Thus, government is not only the solution; it is also the problem. Distinguishing between what government can do to promote security and what it must cease to do because it inhibits security is critically important.

Security is also very important as an incentive for voluntary exchange. If a person or business fears that some of their surplus will be taken away by force or by government intervention, they are likely to either, a) reduce the amount of time and effort devoted to creating the surplus (if what you produce is taken away, why do so much of it?), or b) build up defenses to prevent the transfers (i.e., invest in fences and locks, or hire tax lawyers to reduce tax liability, etc.) In contrast, if people and businesses feel more secure, then greater exchanges and fewer defensive responses will arise, thus enabling greater economic efficiency.

Compassion

Enabling and encouraging voluntary transfers promotes compassion. Compassion involves helping those who are least able to help themselves, or giving to those who are most in need. One may classify those less fortunate, or those who suffer from terrible maladies, as victims. Probably everyone has been a victim at least one time in their lives. People are victims anytime they, or someone they are close to, are injured or killed. People are victims anytime someone steals or defaces their possessions or property. Sometimes people are victims when they suffer losses in a natural or manmade disaster, such as a hurricane or a chemical factory explosion.

It is common for people to rally around to support those who suffer from serious losses. Families help each other every day. People contribute to their churches, to charities and other non-profit organizations, all of which devote time and resources to helping people in need. These are all examples of compassionate voluntary transfers.

Governments too make transfers to those in need. These come in the form of social insurance, welfare, food stamps, and unemployment compensation. Whether these government transfers are voluntarily provided by the taxpayers, or what proportion is voluntary, is arguable, as discussed in Chapter 9. Nevertheless, some portion of government transfers surely corresponds to compassionate voluntary transfers.

Voluntary transfers also provide a solution to the losses that some individuals will face in a competitive market economy. However, this common suggestion to provide compensation is problematic because it generally would require the use of involuntary transfers to be fully effective. In addition, automatic compensation is likely to reduce the incentives to adjust to changing market conditions and would act to reduce efficiency effects. Voluntary transfers, when encouraged, can arise to alleviate the losses to those who are most negatively affected; not automatically, but on the basis of true compassion by those more fortunate towards those less fortunate.

Freedom

Individual freedom is promoted whenever voluntary decisions are allowed and involuntary transfers restricted. Freedom is epitomized in the opportunity to exchange freely any items one owns, or any service one can provide, with whomever one wishes. Any restrictions on voluntary exchanges, or any action that forces a change in the terms of exchange (as for example with a tax), must necessarily reduce the freedom of the individual traders. Freedom is a feature of all voluntary transfers. People should always be allowed to give whatever is theirs to whomever they wish, for whatever reason they wish.

However, freedom to do whatever one wants is not absolute. It is subject to one important restriction; namely people are not free to take possessions involuntarily from another. A classic example of something someone should *not* be free to do is to shout FIRE(!) in a crowded auditorium (when there is no fire, of course). Why not? The reason is that shouting fire amounts to an involuntary transfer. Although the motivation to shout fire may seem senseless to outside observers, the shouter must be doing so to achieve some personal benefit. However, to achieve that benefit, the shouter takes away (transfers) the security and well being of the rest of the crowd involuntarily.

It is sometimes stated that people should be free to do anything as long as it does not harm someone else. However, this is not the appropriate principle either. When a new trader enters a market with a more desirable product, a consumer may stop purchasing from a previous seller and begin to purchase from the new seller. As a result, the previous seller is harmed by the presence of the new seller with a better product. However, the harm caused in this circumstance is a by-product of the voluntary exchange process with multiple sellers and buyers. The harm comes from a consumer's voluntary choice to exchange with someone else. Since this is not an example of an involuntary transfer, these actions should be unimpeded. Thus it is not appropriate to claim that people should be free to do anything that does not harm another. The distinguishing criterion must be *the reason* harm befalls another. People should be free to give whatever they own to another either in exchange or unilaterally for whatever reason. People should not be free to take something involuntarily away from another.

Security in one's person and property also enables maximum freedom. When someone feels threatened by another, fearful that he may suffer bodily harm or theft of his possessions, he is forced by that fear to invest in security measures. Security requires the use of resources (e.g., money must be spent to purchase safes, fences and guns, etc.) that detract from what a person might otherwise prefer to do. In this way, even the threat of involuntary transfers affects the terms of exchange and the choices individuals make. If, by magic, one could eliminate the threat of involuntary transfers, then people would be free to pursue fully that which they most desire at no additional cost to themselves. However, because the prospect of eliminating all involuntary transfers is idealistic, security comes at a cost. Devising a method to inhibit involuntary transfers in the least costly way, while promoting all other voluntary activities, is the path to maximum individual freedom.

Justice

In the debate about globalization it is common for people to argue in support of fairness and social justice. But what exactly do people mean? Chapter 4 argued that there are multiple fairness principles, all of which are individually reasonable, but which conflict with each other when applied to specific public policy issues. Despite that conflict, now, we can respond with a simple definition of justice.

Justice prevails with the simultaneous application of the compromise principles: promotion of voluntary exchange, promotion of voluntary transfers, and the restriction of involuntary transfers. If a society can apply these principles, individual opportunities will abound, economic efficiency will be enhanced, security in one's person and property will be maximized and those least fortunate will be the recipients of compassionate voluntary outpourings. Individual freedom will be maximized as well.

How such a society will look is anyone's guess since whatever arises will be the result of innumerable individual decisions, not the result of control at the top. The economy and people's lives will go where the individuals themselves want them to go and not where a government, or a group of influential people, prefers.

One thing missing from these principles of justice is any discussion of the distribution of income. Adhering to these principles says next to nothing about how unequal the income distribution will be and provides no centralized control over the outcome. Nevertheless, adhering to the principles will assure that people who give the most to others, via the voluntary exchange process, will be the ones who earn the highest incomes. Let me reiterate, …. those who give the most, receive the most! Adherence to the principles will also mean that high incomes will not accrue to those who have taken advantage of others using involuntary transfers. Hence the income distribution that does arise will be merit-based. Finally, although low incomes will accrue to those who are less lucky or less fortunate, a compassionate society can choose to reduce any inequities and provide for a safety net to assure that no one suffers unconscionably.

Lastly, achieving justice, as defined here, does not require an outpouring of altruism and the diminution of egoism. Egoism and the pursuit of profit is a characteristic that is absolutely necessary to promote true justice. Without individual desire to promote one's self interest, there would be little motivation to engage in voluntary exchange and without exchange would come a dramatic reduction in productive efficiency effects and a drop in a society's average living standards. However, this definition of justice does not condone *every* individual action to promote self-interest since benefits arising out of involuntary transfers are soundly discouraged. Thus, true justice requires egoism to be directed appropriately; the right application being a necessary condition to achieve greater prosperity while the wrong application being responsible for many of society's perceived problems. Finally, altruism is not the antidote to egoism as often suggested. Instead altruism provides a compassionate mechanism to relieve the suffering of those less fortunate, not as a substitute for appropriate egoism, but as a complement to egoism.

Policy Recommendations: Applications of the Heuristic Mechanism

The compromise mechanism is a method to evaluate policies. With these principles in mind we can now discard the traditional techniques that try to measure who wins and who loses. Instead of asking what the benefits and costs of different policy choices will be, we can now ask: what do the justice principles imply for trade policy, for immigration policy, for environmental policy? How do they change our perceptions of the role of government? When are taxes appropriate and how should they be collected? What is the role of the judiciary? How can a system best be devised that simultaneously promotes efficiency, freedom, security, compassion and justice? Below I'll apply the principles to a collection of issues relating to globalization. In many instances we need only to enforce laws that are already in place. In other instances there may be a need to adjust the laws or regulations slightly. Finally, sometimes the principles call for a complete dismantling of current policies.

The list of polices considered below is a selected sample that are prominent in the globalization debate. However, the principles apply to every public policy discussion. Readers and researchers are encouraged to use and apply these principles to a much broader class of issues.

Lastly, the policies that follow from the principles should be regarded as goals to be achieved in the future. I say this fully cognizant of the fact that implementation of these policy options is likely to be very difficult. Resistance to change will be strong since complete implementation will cause some parties to knowingly lose relative to the status quo. Nevertheless it is important to identify goals to strive for and justifications for those outcomes. Currently we seem to be going around in circles with respect to globalization policy and public policy more generally; sometimes choosing to be more liberal and other times choosing to be more restrictive. In all of the discussion it is hard to identify an ending point. The purpose of the next section is to suggest simple and definitive policy objectives together with clear rationales for the choices.

Goal #1) Choose Free Trade

Freer trade in goods, services and international investment, together with the technological changes, like the advancement of telecommunications, are perhaps the most important changes that have inspired the mad dash towards globalization in both economic and social contexts. Still, free trade remains a widely contested policy. Both supporters and opponents of freer trade and globalization make their cases by analyzing the effects of various policies and asking whether each policy would make the people of a country better or worse off. Both sides assess the effects using different measures of well-being and different norms of justice and fairness. Unfortunately though these approaches do not provide convincing answers.

The compromise mechanism suggested here offers a new way to make judgments about policies, based not on imperfect measures of individual and global effects, but rather on the basis of simple principles. With regard to the issue of trade policy, the mechanism clearly supports free trade, without exception.

Free trade means the removal of impediments to free voluntary exchanges between residents of different countries. Free trade is clearly pro-competitive and thus can be thought of as an international extension of anti-trust motivations. As such, it is the extension of voluntary exchange to an international context.

A free and competitive system provides an answer about what to do in the face of great uncertainty. Not only are the overall effects of government policy changes unknowable, so is knowledge of what consumers really want. In a dynamic ever-changing world economy, even firms themselves won't know for sure how to best provide products for their customers in the future. What sells today, may not sell tomorrow. Thus, the most effective way to discover consumer demands and desires is for numerous firms to freely compete with each other. In the process, an economy will experience a continual churning of creative destruction. The creative destruction process itself is like a grand experiment, constantly being run and re-run to determine how best to serve the primary interests in society; that being the pursuit of individual happiness, as the individuals themselves define it.

Note that this recommendation for free trade is not based on the argument that free trade is most efficient or even that we can know that it is *best* in some overall or aggregate sense. The inability to measure the overall effects of any policy means that we have as little chance of verifying the superiority of free trade, as we have of verifying every other policy ever proposed.[i] Instead free trade is supported on the basis of simple principles - the moderate principles. In turn, those principles were derived by asking what we might do to design policies if we accept the premise that we know so little.

Alan Greenspan highlighted the promise and the problems of the free market system in his memoirs, writing:

> The problem is that the dynamic that defines capitalism, that of unforgiving market competition, clashes with the human desire for stability and certainty. Even more important, a large segment of society feels a growing sense of injustice about the allocation of capitalism's rewards. Competition, capitalism's greatest force, creates anxiety in all of us. One major source of it is the chronic fear of job loss. Another, more

> deeply felt angst stems from competition's perpetual disturbance of the status quo and style of living, good or bad, from which most people derive comfort. …. 'creative destruction'—the scrapping of old technologies and old ways of doing things for new—is the only way to increase productivity and therefore the only way to raise average living standards on a sustained basis. (p. 268)

Any restrictions to international trade represent impediments to voluntary exchange, while simultaneously promoting involuntary transfers. For example, a tariff or quota is known to cause a redistribution of income. Some people lose income because of the tariff while others gain, both at home and abroad. Those who lose, have money, or benefits, involuntarily taken away. In light of this, it is the impediments to free trade, typically justified on the basis of self-serving interests, that conflict with the moderate principles, not free trade itself.

The alternative to free trade is what we might call selected protectionism. These are trade policies implemented to correct for certain perceived problems. Among the most important are trade remedy laws, agricultural protections and infant industry protections. We'll consider these exceptions to free trade next, and evaluate them with respect to the moderate principles.

Goal #2) Dismantle Trade Remedies

The WTO-sanctioned trade remedy laws - antidumping, antisubsidy and safeguards - are available to provide protection from foreign competition for import competing firms in certain situations. In antidumping and antisubsidy cases, the justification for protection is unfair foreign competition. Antidumping actions are allowed if foreign firms sell their products too cheaply in the domestic markets and cause economic injury to domestic competitors. Antisubsidy actions are allowed when the foreign government subsidizes exports thereby causing imported products to be sold too cheaply in the domestic market and causing injury to the domestic firms. Finally safeguards are implemented when a sudden increase in imports of a product occurs causing injury to the domestic import-competing firms.

In all of these cases, trade remedy actions involve raising the import tariff to correct for (or remedy) the perceived trade problem. The protection granted does just that; it *protects* the domestic firms from foreign competition. It does so by restricting the free voluntary exchanges between domestic consumers and foreign firms at mutually agreeable prices.[ii] The effect of the protection is also to transfer money involuntarily from some consumers and foreign producers towards the domestic firms. As such the remedies themselves violate the compromise principles because they restrict voluntary exchange and use government regulations to instigate involuntary transfers.

The fact that domestic firms welcome such policies is no surprise. Firms are always eager to find mechanisms that enable them to restrict competition. In this case it is the government actions themselves that facilitate an anticompetitive outcome.

Of course, the justification for antidumping and antisubsidy is the purported unfair actions of foreigners. In antidumping cases, foreign firms may be using a monopoly position abroad to enable them to underprice their product in their export market. That monopoly position represents an involuntary transfer process abroad. Similarly, in antisubsidy cases, the foreign government subsidies represent an involuntary transfer process that provides competitive advantages to the foreign firms. Thus, domestic firms are injured because of foreign government use of involuntary transfer policies.

In the safeguards case, the remedies do not protect against unfair actions but instead offer temporary protection in circumstances of extreme competition (a sudden surge of imports) and market churning. Thus, safeguard actions are pure involuntary transfers that do not counter foreign involuntary transfers. As such they are a prime example in which industries have used the power of government to implement regulations that restrict competition in difficult situations. The prime losers are the domestic consumers who must pay higher prices and for whom free voluntary exchanges with foreign firms have been restricted.

The ideal policy outcome in terms of the compromise principles is clear: the complete elimination of trade remedy laws. This means, paradoxically, that to be more fair, we should eliminate the trade laws purportedly protecting against unfair trade. The problem with trade remedy laws is that they correspond to a manifestation of involuntary transfers – some groups in the economy benefit at the expense of others who have little to no say in the matter.

In instances when foreign monopoly positions exist or when foreign government subsidies enable dumping, a more appropriate and efficient response is either a) to directly eliminate the foreign involuntary transfer process, or b) accept the cheaper foreign products. Although trade remedies can be thought of as inflicting harm upon foreigners, because of the harm they've caused us (an application of negative reciprocity fairness), one can argue that two wrongs (i.e., two instances of involuntary transfers) cannot make a right. Better to work towards the elimination of foreign monopolies and subsidies in order to achieve a more truly competitive international economy, rather than pile more involuntary transfers on top of existing ones.

Indeed, such advice is consistent with the theory of the second-best described in Chapter 2. Second-best theory says that the best policy options are always the ones that attack the market distortion or imperfection most directly. In this example, one would classify the foreign involuntary transfer policy as a distortion because the action involves the taking of property, mostly from the import competing firm. However, the trade remedy action by the importer government also represents a distortion since it involves another involuntary transfer action, effectively taking property back from the foreign firms.[iii] While it will always be true that correcting one distortion with another can raise the well being of some participants, the better policy overall is the elimination of both distortions; i.e. foreign firms do not acquire monopoly positions or receive subsidies from their government, and importing countries do not use trade remedies.

Goal #3) Dismantle infant industry protections

Developing countries often use the infant industry argument to justify protection. According to this argument, firms in developing countries cannot compete in head-to-head competition with firms in developed countries and thus need to be protected until they can become more efficient. Although in theory, infant industry protection, appropriately implemented, can improve the well being of a country, the argument suffers from the serious information problems described earlier; namely that it is impossible to know which industries to protect, at what level to protect, how long to protect, and whether the protections will really have a net positive effect. Consequently, the use of this policy is like a shot in the dark at a moving target.

More importantly, infant industry protection clearly discourages both voluntary exchange and the competitive discovery process. This means that firms and the country would be less likely to foster the dynamism that would be achieved with more competition. Nevertheless, infant industry protection draws wide support, largely because the involuntary transfers that result from protection, transfers primarily from domestic consumers to domestic firms, make conducting business decidedly easier for the import-competing firms. These firms engage loudly in domestic policy debates and use rhetorical methods to convince their own governments to implement or maintain these policies.

Bear in mind that the proposal to dismantle infant industry protections is not based on some empirically-determined guarantee that freer trade will automatically improve the well-being of the nation. Just like we cannot know whether infant industry protections will have positive overall effects, we also cannot know if freer trade instead will have positive effects. Thus, the proposal to eliminate protection is based on the positive aspects of the compromise principles themselves in the face of imperfect knowledge about which policy is best.

Goal #4) Fight Corruption and Bribery

For a developing country a critical factor affecting a movement to freer trade is the number of other market imperfections and distortions that remain in place. Perhaps the most worrisome are those representing egregious forms of involuntary transfers. For example, among the key problems facing developing countries are inadequate legal protections for private property; or when protections do exist, inadequate enforcement of those rights. These institutional problems can result in widespread corruption. Corruption, such as bribe taking, government favoritism, or outright theft, not only inspires contempt within society, but is also likely to discourage voluntary exchange activity. Afterall, if one cannot secure ownership of one's property, or if one's hard earned profit is whittled away by the bribes one must pay to stay in business, or if profit is stolen away by corrupt officials, then where is the incentive to produce? Or, as is more likely, why not give up hard work and productive activity entirely and redirect one's efforts towards corruption for your own benefit? If everyone else is corrupt, why not engage in corruption oneself, especially when it is easier to do so?

If free trade is implemented in a country with weak legal institutions and widespread corruption, it is not at all clear that the promotion of *international* voluntary exchange activity will inspire more *domestic* voluntary exchange activity. If instead, the international exchange merely provides greater opportunities for involuntary transfers, or if opportunities for corruption expand in some way, then free trade alone will not offer an adequate solution.

Essentially, this is why the advice of Western economists to implement free market shock therapy in the former Soviet republics failed miserably. Russia and most of the other newly independent states simply did not have the appropriate institutional mechanisms in place to prevent the widespread theft of state resources that occurred once state control was eliminated. Instead of promoting a free and open environment for voluntary exchange, shock therapy initiated large-scale involuntary transfers leading to widespread corruption.

This is not to say that there are exceptions to the compromise principles; instead this is an argument that the sequencing of a transition to freer trade is important. The advice remains to eliminate as many involuntary transfer activities as possible and promote voluntary exchange. For developing countries however, it may be necessary to solve the domestic involuntary transfer problems before free trade and the promotion of voluntary exchange can become effective. These policy guidelines merely identifies the goal and the justification for that goal, it does not yet offer a guide to the sequencing of changes, or the best transition path.

Corruption is not a developing country issue entirely. In every society, corruption, bribery and other nefarious practices are common. All such practices are examples of involuntary transfers deserving of legislative prohibitions and enforcement. Although it may never be possible to eliminate these practices entirely, the establishment of a strong judicial system capable of prosecuting and punishing corruption can serve as a deterrent.

Goal #5) Dismantle Agricultural Supports

Most of the developed countries in the world, and many others as well, support their domestic agricultural industries. In some cases this involves high protective tariffs on imports, but more notably, interventions involve domestic price supports and other income maintenance programs. Agricultural subsidies measure in the hundreds of billions of dollars annually around the world. The arguments used to justify these policies range from the need to provide insurance from fluctuating prices, to the need to provide for self-sufficiency in food in the event of a national security crisis.

Although these justifications have some validity, they also mask the fact that these same support programs raise food prices thereby inhibiting voluntary exchanges, reduce competition for domestic agricultural firms, and transfer money involuntarily, largely, from consumers and taxpayers to producers. Agricultural industries are strong supporters of these programs because they effectively reduce competition and make their business easier. Unfortunately, the cost of business security is borne by domestic consumers and taxpayers. In light of the compromise principles, agricultural support programs should be dismantled in order to promote voluntary exchange and the dynamic competitive effects in the agricultural industries, and to eliminate the involuntary transfers that support programs engender.

Goal #6) Allow international factor mobility (including immigration)

Factors of production, both capital and labor, often move to other locations to take advantage of profitable opportunities. When a company decides to move an assembly plant abroad, it is because they expect to be able to reduce production costs, lower the price of their products to their customers and improve their competitiveness. When workers move to another country, they expect that the job opportunities available are better than the ones at homes. That may be because the opportunities at home are non-existent or meager, or because the available jobs abroad pay substantially more. The profit opportunity in working abroad in the US and Europe is so great that many people are willing to emigrate illegally and risk prosecution to achieve their goals.[iv]

The debate over immigration is often intense. Numerous studies have been done to assess the effects of immigration. Does immigration reduce wages, raise or reduce economic growth, raise or lower poverty rates, increase crime rates, or increase social conflict? No matter how many studies are done though, we will never know with much confidence what are the overall effects of immigration. Clearly some groups will recognize how greater immigration will increase competition in their own industry, or their own labor market, making it more likely they'll suffer adjustment costs. Others, especially firms that hire immigrant workers, recognize that they will benefit from greater immigration. Due to the inherent uncertainties, the rhetorical political debate is unending. The alternative is to set immigration policy on the basis of the compromise principles rather than attempting to convince people using conflicting benefit-cost analyses.

The application of the principles is simple. For both companies and workers, factor movements like immigration are merely examples of mutually voluntary exchanges. Immigration restrictions and impediments to capital mobility are policies that restrict these voluntary exchanges from occurring. They serve to reduce competition for some domestic firms and workers and as such provide involuntary transfers to those protected.

In light of the compromise principles the appropriate policy goal is the removal of impediments to international factor mobility. That means free capital mobility and freedom to immigrate. Of course, immediate and complete factor mobility, especially for workers would certainly cause tremendous adjustment costs as workers from poor countries might be expected to flood into developed country economies. Thus, from a practical perspective, it makes sense to increase immigration and capital infusions gradually over an extended period. Nonetheless the long-term goal should be a world in which workers and companies could move freely to whatever location they expected to profit the most by participating in allowable voluntary exchange activities.

There are several other problems to deal with though, especially with respect to immigration. One problem is the potential for immigrants to profit by taking advantage of social services in the host country. In this case their profit arises from the “voluntary” contribution to the social safety net by domestic taxpayers, who may not be happy to see their taxes spent on non-citizens. In other words, host country taxpayers would reasonably view this as an involuntary transfer. One solution to this problem might be restrictions on immigrant claims to social services for a period of time. If migrants knew they could not profit via transfers in a host country, they might be discouraged from migrating unless they expect to find work. Second, social services for poor jobless immigrants could be provided for with voluntary contributions to NGOs designed to fulfill these needs. For example, working individuals in a community of immigrants might be willing to contribute to a fund that would offer assistance to social service support to others in the community. In this way, a local safety net would be provided via voluntary contributions and not at the unwelcome expense of a larger and disconnected set of domestic taxpayers.

Although this discussion merely scratches the surface of the issues arising in the immigration debate, the suggestion here is to apply the compromise principles to each of these issues. The guidelines implore one to ask whether a policy proposal enables or restricts voluntary exchanges, whether it introduces or restricts involuntary transfers, and what role voluntary transfers can play in the solution.

Goal #7) Provide a generalized safety net (not targeted protections)

Since an economy in free trade will be filled with stress and anxiety as agents struggle to compete, a compassionate society will undoubtedly wish to provide a safety net for those agents who, for any reason, suffer continual and persistent losses, or who simply do not have the capacity or good fortune to achieve some minimal standard of living. The minimal standard deemed appropriate will surely vary from country to country but will likely be higher the higher the average income of the country. The larger the surplus a society can generate, the greater its ability to give up some of that surplus to benefit those in need.

The need for a safety net is apparent when we understand the true nature of a competitive system. Despite claims by free trade or pro-free market advocates that everyone benefits in an free, open and competitive economy, the real truth is that competition is likely to cause persistent losses for the weakest agents in the economy. The weak will be those who on average have lower skills, do not work as hard, have physical or mental disabilities, or simply suffer from persistent bad luck.

The compromise principles though requires that, a) a safety net does not eliminate or reduce competition within the economy, (i.e., do no restrict voluntary exchanges) and b) the safety net provides for transfers voluntarily (i.e., do not force people to help others via involuntary transfers).

For example, consider a government welfare program that transfers income to those individuals with incomes below some prescribed poverty line. To conform to the blueprint, the taxes used for these transfers should be taken from a group of willing taxpayers. If taxpayers are not willing, non-profit institutions funded by voluntary contributions or donations could provide such a safety net. Alternatively, individuals could use private insurance to protect themselves from temporary losses.

These voluntary transfers should act like a general insurance policy for anyone who suffers persistent or unconscionable losses. Programs could target anyone whose income falls below a certain level and who has no wealth to draw upon. Or, programs might target those who suffer from medical or health problems that prevent them engaging in the market economy. Finally, programs might target the elderly poor who would not be expected to engage in market activity.

In contrast, many protection programs, such as trade adjustment assistance, provide support only for workers who lose their jobs because of one particular problem; increased imports. These policies are discriminatory because they do not cover all individuals who might suffer similar negative competitive circumstances. For example, why do workers in import-competing industries deserve more protection than workers who lose jobs because of technological change?

Safeguards legislation is another example of protection for industries that suffer from a surge of imports. This protection can be thought of as a type of safety net since it will help preserve the jobs in the import-competing industry. However, in this case, protection for some agents is possible only by reducing competition in the import-competing industry, thereby restricting voluntary exchanges. Thus, this policy is not consistent with the compromise principles.

A discussion of how to most effectively maintain competition and simultaneously provide a social safety net is beyond the scope of this study. The point here is to argue that a safety net provision is consistent with the mechanism but that the best design for a safety net is one that promotes voluntary transfers rather than relying on involuntary transfers. Indeed, it may not even be necessary for government to be the main provider of a social safety net. Ideally, families, neighbors and communities could provide support for people in need. The establishment of numerous NGOs, each fulfilling a different community purpose, and financed via local voluntary community contributions could form the basis for a substantial portion of the social safety net. President George

H.W. Bush referred to these organizations as a "thousand points of light" to suggest that when their impacts of many small organizations are cumulated, they can actually have a very significant total effect on a nation. Encouragement of these types of NGOs, serving community needs, is fully consistent with the compromise principles.

Epstein (2003b; p. 59) points out that voluntary activities are often extensive and it is a mistake to think that laissez-faire "stifles the expression of individual compassion.' However, he also cautions that, "(m)odern political institutions have dulled many of those charitable impulses. When the state takes responsibility for the care of the needy, it crowds out private benevolence with public coercion."

Goal #8) Allow Voluntary Alternative Trade: The Fair Trade movement

Some groups concerned about low wages and worker exploitation in developing countries have decided to take matters into their own hands. Concerned about the low wages of workers in developing countries, these groups have introduced a unique new way to empower consumers who may prefer to purchase goods they know have been fairly produced.

The Fair Trade product market was established by several non-governmental organizations. Products such as coffee, tea, bananas, rice and cocoa can be purchased in developed countries bearing a Fair trade label. The label attests to participation in a wage verification system guaranteeing that the farmers producing the primary product were paid a fair wage. The system uses funds paid by the developed country merchants to operate a monitoring system to assure that the non-profit agency's rules are followed. The rules typically require a minimum price be paid per unit to the poor farmers regardless of market conditions, and that basic labor standards be observed. The system offers developed country consumers the opportunity to pay slightly more for their coffee and other products to acquire not just the product but also the knowledge that their purchase does not exploit developing country workers.

The Fair Trade product system is perfectly consistent with the compromise principles primarily because it is voluntary. The system is run by NGOs. Consumers choose whether to pay more for goods with special characteristics. Firms are also allowed to choose whether to participate or not. Although this system may seem to alter the "free market" prices for inputs, it doesn't because the higher price satisfies a latent consumer preference for particular product characteristics. To the extent that additional money is transferred from consumers to the farmers, the transfer represents a *voluntary* transfer. Also, since none of the businesses are forced to change their behavior, the system does not hinder voluntary exchanges. Of course, this consistency with the compromise principles would change if governments were ever to step in to enforce and expand the process.

Prior to the Fair Trade product movement a similar consumer demand drive was undertaken with regard to sweatshop labor in the clothing and apparel industry. Students and others were encouraged not to buy products from companies or countries where there was evidence of sweatshop labor conditions. One product line especially targeted was college-labeled sports wear and shoes. Among the most prominent targeted company was Nike. For several years, outcries, especially by students on college campuses NOT to buy Nike and other products led to careful examination and widespread press coverage of the working conditions in many less developed countries whose factories were producing products to be sold in the developed world. Of course there were numerous problems with interpretation of the evidence. What to one observer was the gross violation of human rights, was to another observer the normal working conditions in developing countries, offering workers a chance to slowly work their way out of poverty. Nonetheless the sweatshop labor movement was largely consistent with the compromise principles, at least in the early stages.

The revelation of any type of consumer preference, even if it relates to the manner in which a product is produced, is perfectly consistent with voluntary exchange. One effect of the movement was to inspire companies like Nike to evaluate and monitor the working conditions of its workers in less developed countries. Although these efforts did not assuage all objections, it was clear that Nike believed it was in their interests to respond to this consumer movement. Eventually, the movement extended its reach by pressuring college administrations to cease purchases of certain product lines in their campus stores. Although a request for these changes is unobjectionable, the implementation of this request would begin to infringe on individual's free voluntary exchanges. Some college students, those who didn't particularly care about the sweatshop characteristics of their garments, would be slightly restricted from purchasing freely if the university restricted certain sales. I say *slightly restricted* because these students would not be completely prevented from purchasing similar products elsewhere, albeit with higher search costs.

However, if this same type of request were expanded to the national level with government involved, the intervention would become much more objectionable. For example, if the movement convinced the government to implement import restrictions on egregious products, then everyone in the country would be forced to adhere to the preferences of one special interest group. Legislation such as this would inhibit voluntary exchange activities. Also, because the import restrictions would generate automatic redistributions of income, the action would involve involuntary transfers. Thus, although a consumer driven sweatshop movement is consistent with the compromise principles, a government-sponsored response is not because it shifts the process from voluntary to involuntary.

Goal #9) Prevent Worker Exploitation via Competition

There is an alternative free market process consistent with the compromise principles that could conceivably work to mitigate the problems associated with low wages and sweatshop working conditions. Recall that all transactions are meant to be mutually voluntary which includes the hiring of workers by a business. Consider a company that mistreats its workers, either by paying unusually low wages or with poor working conditions. If the exchange is truly free then workers who believe they are mistreated have no need to continue: they can simply walk away from the job. If they do so, the firm will begin to lose those workers who have better opportunities elsewhere, which will also be the more productive workers. As better workers flee, productivity will fall and the firm will have difficulty maintaining output. In the extreme, it may be forced out of business. In contrast, if a firm treats its workers better, it will attract and retain the more productive workers. The firm's efficiency will rise and it will have a better chance to succeed.

In a developed country context, Costco is an example of a company that employs this strategy effectively. Costco pays its workers considerably more in both wages and benefits than its major competitors. As a consequence they have an extremely dedicated and loyal workforce, which they mobilize to produce a superior product for their customers. Of course, the fact that a system can work for a firm like Costco does not imply that the same process can work with the market conditions in a developing country.

Undoubtedly, many workers in developing countries are exploited. Some workers arrive in cities from the countryside with an imperfect understanding of how the economic system works. Sometimes they are enslaved by trickery or threats of violence. Although the mechanism does not offer an immediate solution to these problems, it can inspire us to investigate policies that move closer to the idealized free market solution; that which promotes voluntary exchanges and transfers while restricting involuntary transfers.

As discussed in Chapter 2, the best solution to any market inefficiency is to be found with a policy that comes closest to fixing the inherent problem. In the case of worker exploitation, the problem is often related to imperfect information on the part of poor workers, inadequate legal protections from violence and fraud, and inflexible labor markets. Other proposed solutions, like the Fair Trade product movement, attempt to convince consumers that they should be concerned about the well being of distant workers and need to monitor the production processes of the products they buy. However, since consumer indifference in the developed countries is not the real source of the exploitation, it seems unlikely to be very effective in changing the system.

Effective free markets may require a good understanding by the market participants of how a market is supposed to work, including knowledge of legal protections for contract enforcement and other such matters. An NGO that provides legal services to workers can offer valuable information to help smooth the workings of the market. If the funds for the organization are collected from independent donors, like philanthropic foundations, then it represents a voluntary transfer response that can help promote voluntary exchange activity. Paradoxically though, if an NGO helps workers to organize unions to force up its wages collectively, then its activities may encourage involuntary transfers. Although many people accept unions as a necessary worker right, it is important to recognize how the empowerment of unions can also inhibit mutually voluntary exchanges. As such, this type of response represents an involuntary transfer solution to involuntary transfer exploitation and does not conform to the compromise principles.

Goal #10) Accept Outsourcing and Offshoring

The issue of outsourcing offers a prime example of the usefulness of the compromise principles in making policy judgments. Outsourcing is a business practice in which services previously provided by in-house employees are now provided by a separate firm. For example, a business might decide to hire another company to provide janitorial services. When the external firm is another domestic firm, outsourcing raises few complaints. However, when the external firm is a foreign firm then the outsourcing is known as offshoring and it often raises vociferous objections.

In recent years offshoring has developed as a highly contentious issue in the US and EU as multinational firms have been able to take advantage of the falling cost of telecommunications to shift certain types of jobs to countries like China and India. Whereas traditional trade with these countries may threaten jobs in labor-intensive industries, offshoring has begun to affect the job prospects of highly skilled professionals like computer programmers and medical technicians. That has inspired a dramatic change of heart among many who have been traditional supporters of freer trade. People now claim that the world is different than ever before. Some contend that the traditional economic theories no longer apply. That things are changing more rapidly, there is no question; that the old theories do not apply though, is simply hogwash!

The compromise principles provide a simple answer of what to do about offshoring; do nothing, allow it to happen. Offshoring represents attempts by companies to lower their costs of production and provide a better service for their customers. Offshoring arises because of the dynamic competitive process and is a clear manifestation of voluntary exchange activity. The only thing new is the ability to outsource abroad; something that has not been readily available to firms previously because of the higher international costs of service provision.

Offshoring is also a manifestation of the creative destruction process. Once firms realize a cost reducing possibility they should be allowed to take advantage of it because by doing so they are better able to fulfill their fundamental purpose, which is satisfying their customer desires. The firms that do so most effectively will remain in business, while those that do not will ultimately be destroyed. That workers will suffer losses is expected in a dynamic economy and is not a sufficient excuse for policies to protect these jobs.

Every worker in a dynamic competitive economy faces a potential adjustment. A lost job, either from outsourcing; or because of imported goods; or because a WalMart opens up down the street; or because an export firm loses out to its other competitors and begins to downsize; all are a part of a dynamic competitive economy. The reasons for job losses are multifaceted and ever changing and they can just as easily affect a production line worker as a top executive. There is nothing special or different about lost jobs because of outsourcing.

For those who suffer losses from outsourcing though, it makes perfect sense for them to construct rhetorical arguments to support protective legislation. It makes sense to argue that the world is new and the old theories no longer apply. By building these arguments, workers everywhere may begin to fear job losses and lawmakers may more likely respond with legislation regulating this “new” phenomenon. However, these responses are clearly anticompetitive. They will result in involuntary transfers between consumers and the protected workers and they will be highly discriminatory since the laws will differentially protect those who might suffer a job loss from offshoring but not from other competitive adjustments.

Goal #11) Encourage Worker Preparedness

So then what are workers whose jobs are threatened supposed to do? The best response is an individual one to prepare for the worst. A competitive market will function most effectively if workers understand the vagaries of the system and if they realize that calls for protection, meaning calls for involuntary transfers, will go unanswered. A prepared worker is one who is continually improving his education, constantly in search of better opportunities and resilient enough to persevere in the event a job loss occurs. Opportunities for protection, unfortunately, can act to redirect worker efforts away from what is necessary to land a better job, towards attempts to save one’s current job. These efforts are wasteful since they represent activities to secure involuntary transfers rather than efforts directed at useful production.

Tony Blair, the former prime minister of Great Britain, did an excellent job, especially for a politician, in describing the appropriate worker and societal attitudes that are necessary to maintain these compromise principles when he said,

> "The character of this changing world is indifferent to tradition, unforgiving of frailty, no respecter of past reputations. It has no custom and practice. It is replete with opportunities, but they only go to those swift to adapt, slow to complain, open, willing and able to change. Unless we "own" the future, unless our values are matched by a completely honest understanding of the reality now upon us and the next about to hit us, we will fail. …. In the era of rapid globalization, there is no mystery about what works — an open, liberal economy, prepared constantly to change to remain competitive."[v]

As Blair suggests, we need a completely honest understanding of reality if we expect to succeed and thrive in the new global economy. But complete honesty and the rhetoric of politics do not mix well. This is the first important obstacle to overcome.

The second thing Blair's remarks highlight is the nature of the global competition that is upon us. Competition is "indifferent to tradition, unforgiving of frailty, and no respecter of past reputations." A competitive market is "replete with opportunities," and these opportunities will go to those who are most adaptable and least resistant to change.[vi]

Change is inevitable. Competition inspires change. And with change comes many of the good things that we seek for society. However, to promote the opportunities that will come with change, requires acceptance of the painful effects, both immediate and ongoing, of a dynamic competitive system. The pain associated with the competitive process will never disappear. Nor should we want it to disappear, because competition and the fear and anxiety it engenders serves as the prime catalyst for firms to discover what consumers really want. Ultimately, many of the benefits will go to those who are not traditionalist, not frail, and who are most amenable to change itself. This may imply that wealthier, better-educated, harder working people will more likely succeed. Although even this generality may not always be true as evidenced by the high wage jobs lost to offshoring; in other words, no one is immune from the process. Losses in the adjustment process will more likely accrue to the poorest, weakest, frailest, and least educated. The response to these losses, though, should not be the targeted protections to the industries most affected but rather the application of a generalized and voluntary safety net as described above.

What about Income Distribution?

One of the major policy debates over the past few centuries has been the debate between equity and efficiency. Equity generally refers to the equality of income or well-being. Efficiency refers to the productiveness of the economy. Indeed, one of the major concerns about the effects of trade liberalization is the effect on income distribution. As globalization proceeds, many people are concerned that incomes are becoming less equally distributed both internationally and nationally. A common claim is that the rich are becoming richer and the poor poorer.

Numerous studies have been done to assess the income distributional impacts of various types of policies. Not surprisingly, the results are mixed. There are enormous difficulties even in identifying what is the proper instrument to use to assess inequalities. Although measuring income is standard, income is used largely because it is regularly measured rather than because it is the best way to denote individuals' well-being. Assessments of the psychological impacts from policies, impacts such as cultural or environmental effects, are primitive at best. Consequently, it seems highly unlikely that we could ever come to an agreement about what the ideal distribution of well-being should be and whether a nation or the world is close or far from that ideal.

Despite the uncertainties, policies to redistribute income are in place in most countries. The motivation to assess progressive taxes, so that the wealthy individuals pay a greater share of income than poor individuals, is largely based on the desire to redistribute from richer to poorer.

But why redistribute; on what basis? Should the redistribution result in a complete equalization of income across individuals, across households, or across states? What about the equalization of other happiness factors, like health, freedom, or opportunity? Can these be achieved merely with redistributive taxation? It seems that after the failure of socialist economies to achieve adequate productive efficiencies in the pursuit of greater equality, few people today seem to insist that incomes be *completely* equalized, perhaps because there are clearer indications of an equity/efficiency tradeoff.[vii] But that begs the question: how equal must incomes be to be acceptable? And what methods are appropriate to achieve greater equality? These are all difficult questions to answer, but some guidance is provided by applying the compromise principles.

Promotion of free voluntary exchange results in a competitive market economy. In a free market economy there is no clear indication of what the distribution of income will be. Milton Friedman (2002; p.161-2) wrote that "The ethical principle that would directly justify the distribution of income in a free market society is, 'To each according to what he and the instruments he owns produces.'" In other words the more one produces the more one earns. Individuals who achieve higher incomes will be those who have organized capital and labor effectively to produce the goods and services that other people most desire. The greater the surplus generated for others the greater the return for oneself.

Perhaps if everyone believed that the high incomes in today's market economies were directly related to individual productive efforts there would be less outrage about income inequality. Instead it seems likely that people believe that other's high incomes arise not because they have produced much for others, but rather because they have effectively transferred money to themselves from others, involuntarily. In other words, people may desire policies to redistribute income because they believe that the rich are benefiting at the expense of the poor.

To offer one example, many people have a negative impression about lawyers. Lawyers are often regarded as dishonest and many people seem suspicious about the legitimacy of their higher average incomes. A common joke law firm name known as Dewey, Screwem and Howe facetiously expresses this sentiment. Notice, though, that the same sentiment does not seem to apply to doctors who also receive very high average incomes. Most likely that is because people recognize the value in the services provided by surgeons, pediatricians, and family doctors whereas it is much more difficult to see the value lawyers are providing. Although many lawyers are engaged in judicial activities that are absolutely essential to the functioning of our market economy, other lawyers are surely engaged in involuntary transfer activities. For example, involuntary transfers arise anytime deceptive billing practices are used, or when dubious liability claims lead to handsome settlements and high lawyers fees. While all lawyers do not earn income in this manner, that impression is certainly strong enough to have created the popular stereotype.

The same impression may account for the low regard many people have for the very high salaries earned by CEOs, especially when those CEOs oversee a failing business or bank. It is difficult to justify a golden parachute package provided to a CEO that has run a business into the ground or that benefits largely because of government bailouts. Instead what seems obvious to most people is that the wealthy management must be effectively *stealing* money away from others in the organization or from the taxpayers.

These impressions, that the high incomes achieved by many individuals are achieved by nefarious means, surely motivate some of the demands for income redistribution. Nonetheless, several other rationales for income redistribution via progressive taxation are worth considering.

Frank (1985) argues that the desire by individuals for relative status creates a market imperfection. For example, human nature may be such that utility is derived simply by being of higher status (or income) than others in one's community. In this case, income redistribution from higher to lower income individuals can actually raise well-being of the entire community. In a separate work Frank (1995) suggests that winner-take-all markets, in which large returns accrue to a small number of people, leads to an inefficiency because too many people will compete for these limited positions. He argues further that because these markets are becoming increasingly widespread. Progressive taxation, though, can provide an effective mechanism to reduce the inefficiencies.

Nonetheless, the compromise principles suggest the importance of distinguishing between the two different reasons high incomes arise. High incomes occur either because of successful voluntary exchanges or as a result of involuntary transfers (or a combination of both). The compromise principles support the high incomes of the former group but not the latter.

In winner-take-all markets, the high incomes obtained by the winners are justified because they are the outcome of a voluntary exchange process. The high incomes are the return for a comparable surplus generated for others; these individuals gain much because they have given much to others.

A redistributionist income tax policy used to promote greater efficiencies in this case is itself an involuntary transfer mechanism and as such does not conform to the moderate principles. One of the problems with using redistribution involve measurement issues as discussed in Chapter 3. Although in principle progressive redistribution can raise economic efficiency, in practice it would be very difficult to implement in a way that only affects winner-take-all markets and to set the income redistribution rates at the level appropriate to assure that an increase in efficiency actually occurs. Thus, in the end this proposal for income redistribution suffers from the same problem as all of the other legitimate theoretical efficiency arguments for policy; namely, what's good in theory is extremely difficult to implement in practice.

Although a majority of people may favor progressive taxation, for this and other reasons, the people whose incomes are being highly taxed may not share the same sentiments. For these reasons, progressive taxation does not conform to moderate principles, unless it has the widespread support among those who are more heavily taxed.

If it did have their support, then the taxes would fall into the category of acceptable voluntary transfers, which is not an implausible outcome. A society may choose to use the power of government to provide for public goods such as national security, roads, parks AND to provide for the needs of some of the weakest members of society. If widespread support for progressive taxes were a part of a society's goals, then the outcome conforms to the moderate principles. However, if the outcome is obtained via bare majority support driven by those who stand to benefit most from the redistribution, then the outcome would appear more like an involuntary transfer.

Furthermore, it is important to take account of the behavioral effects of redistributionist tax policies. Since taxes discourage the activity being taxed, taxes on voluntary exchanges would surely reduce incentives to produce more for others. That would reduce economic efficiencies and thereby reduce average living standards. Additionally, both voluntary exchange and transfer profit earners would have incentives to defend themselves against the confiscatory taxes. That may involve identifying ways to reclassify income so it is taxed differently, or lobbying the legislature to include some exceptions to the general rules. Individuals may also hire tax professionals to assure that legal tax avoidance is maximized. These activities redirect resources towards directly unproductive activities making the taxation doubly wasteful. Also, to the extent that higher income individuals are able to pay more to engage in legal tax avoidance, they would have an additional advantage over lower income earners.

Finally, the compromise principles may provide an answer for how much income inequality is acceptable. Complete adherence to the principles would create a result in which high incomes arise exclusively because of individual contributions in satisfying the desires of others. To reiterate, those who earn the most would be those who have given the most to others in the voluntary exchange process. Income would be based on merit.

Lower incomes would accrue to those who have contributed less. Thus although incomes would not be equalized, any disparities would arise for justifiable reasons. In the event that low contributions in the economy result in an uncomfortably low income and standard of living for some people, compassionate voluntary redistributions would surely arise to alleviate the suffering of those with the greatest need.

The Role of Government

Bastiat (1998; p.3) wrote, "… nothing can be more evident than this: The law is the organization of the natural right of lawful defense. It is the substitution of a common force for individual forces. And this common force is to do only what the individual forces have a natural and lawful right to do: to protect persons, liberties, and properties; to maintain the right of each, and to cause justice to reign over us all. … If a nation were founded on this basis, it seems to me that order would prevail among the people, in thought as well as in deed. It seems to me that such a nation would have the most simple, easy to accept, economical, limited, non-oppressive, just, and enduring government imaginable—whatever its political form might be."

Milton Friedman (2002; p.27-8) wrote that, "the role of government … is to do something the market cannot do for itself, namely to determine, arbitrate, and enforce the rules of the game. We may also want to do through the government some things that might conceivably be done through the market but that technical or similar conditions render it difficult to do in that way." He goes on to say that "there are two general classes of such cases: monopoly and similar market imperfections and neighborhood effects." The compromise principles are perfectly consistent with these views.

Many policies and institutions suggested by the compromise principles are already operative in modern economies and have contributed to the economic success and prosperity of nations. For example, one critical and necessary institution is a judicial system that sanctions and discourages harmful involuntary transfer activities. Among the most important sanctions are laws prohibiting violence against others and the theft of personal property. These laws, and the punishments levied if someone violates them, not only help to prevent involuntary transfers, but by providing security to one's person and property, helps to stimulate voluntary exchange.

Another important inducement to voluntary exchange is the provision and enforcement of property rights and contracts. By establishing formal and verifiable titling procedures, traders can be more confident that the exchanges they make are with others who have clear ownership rights to the products they are trading. For example, when a real estate transaction is made in the US, there are formal procedures and institutions involved to assure that the seller of the property has title to the property and that any lien holders are properly identified before the transaction is completed. These procedures are costly and are included in the closing costs of major transactions. Nevertheless, these procedures contribute to the legitimacy of the trading system and thereby promote voluntary exchange. In countries where these procedures are not as explicitly formalized, real estate trades are on average more costly because of the increased potential for fraud. Thus, procedures and institutions, such as these, are an absolutely necessary part of a competitive free market system.

However, merely having a judicial system is not sufficient. Some judicial systems work more effectively in some countries because the procedures are applied equally to all, and all citizens have equal access to its protections. In some countries, crime rates are very high because judicial protections and sanctions are weak. Consequently involuntary transfers occur much more frequently. At the same time, because protection from personal injury or theft is higher, voluntary exchange activity is likely to be discouraged.

Some laws are intended to stimulate competition and thereby conform to the principles. For example, antitrust legislation is designed to prevent the formation of monopolies that can raise business profitability at the expense of their consumers. If antitrust achieves this goal, then it is consistent with the guidelines. However, some economists, like Milton Friedman, Alan Greenspan and others, have argued that antitrust legislation may be unnecessary; that if firms are left free to enter any market as they see fit, then the ability of any one firm to maintain a monopoly is extremely limited, if even possible. Thus, some argue that antitrust legislation merely allows the government to punish successful firms.[viii]

Frank (1995) offers another reason to allow for collusive agreements; they can be an effective mechanism to prevent positional arms races. When small improvements in relative position confers a non-proportional benefit, as when a sports team hires all the best players and wins the national championship, a collusive agreement among teams to limit spending can provide a better overall outcome. Thus, the ideal policy design to achieve the pro-competitive objective remains arguable. The spirit and intent of the competition laws is clearly appropriate but their application may or may not be necessary.

However, not all national laws are consistent with the moderate principles, even though all laws are established in a legal process. For example, some laws establish regulations that provide competitive advantages for some businesses over others. A protective tariff is one such example. Political support is often obtained by arguing that protection of domestic firms is necessary to ward off the unfair behavior of foreign firms. But the reality of protection is that domestic consumers of protected products will suffer losses while the benefits accrue to the protected industries. As such these policies, though legal, are nonetheless examples of involuntary transfers.

This suggests that policy prescriptions can never be as simple as saying we need more government or less government. Government plays two roles. First, government establishes laws and regulations, many of which are very important to protect citizens from unbridled involuntary transfers. The smooth functioning of a judicial system that protects property and provides for the enforcement of contracts being perhaps its most important role. Many countries do need more government if by that we mean more enforcement of laws that protect individuals from involuntary transfers. On the other hand, government is also a major facilitator of anticompetitive rules and regulations. Many of the tax and subsidy policies discriminate in favor of politically influential groups and serve to transfer money involuntarily from taxpayers, consumers and other firms. Thus, less of this type of government is consistent with the compromise principles. Epstein (2003b: p.21) points out that, "the dark side of human nature does not disappear just because fallible human beings have assumed the trappings of public office. What are needed are clear rules that define the ends to which public force may be directed."

Thus, groups who argue that government is the source of our problems because they restrict free market outcomes are certainly right. Government is empowered to act this way legally, and they certainly do so. Other groups are suspicious that multinational corporations use the political process to manipulate outcomes in their favor. These concerns are also valid. Business always has an incentive to restrict competition when that competition is strong, or to open up competition when they know they'll have a competitive edge. Businesses frequently solicit the government to implement rules to achieve these goals.

Finally, government can play one other role in its capacity to facilitate voluntary transfers. Because public goods such as national defense can be difficult to finance privately, it can make sense for government to collect taxes from its citizens to provide for the national security. Most people accept this role for government and are willing to pay taxes to finance these expenditures. Thus, to a degree, government provision of public goods is another role to play for government. What is the appropriate level of expenditures is disputable though. Some citizens will clearly prefer greater provision while others will prefer less. How to determine an acceptable level is an issue worthy of further discussion and is beyond the scope of this study. Clearly though, the compromise principles are consistent with some level of government expenditures to provide for public goods.

Conclusion

Most policy guides have a unique problem; a problem this book shares. That problem arises because, after offering one's policy suggestions, together with the logic or empirical support that is meant to convince one's audience, someone, somehow is just supposed to implement the plan. However, there is no single person with the power to implement any proposed plan. Even if you could convince a large group to support one's proposals, that too may be insufficient to assure implementation. Perhaps in a dictatorship the conditions are ripe, but even then, there is a process that must be followed that determines which policies will ultimately be implemented.

For most countries today the process is a representative democracy. Democratic processes rarely take good information about policies and implement them. Instead there is considerable discussion, rhetorical debate, compromises and adjustments. Each of these steps in the process, and many more, influence the final outcome. Thus, to really offer policy prescriptions, one should ideally provide instructions about how to begin and proceed through a political process to achieve the intended result. Examples of this are rare; which implies two things. First, it means that the policy suggestions listed here (as well as in all other policy guide) are impractical. Even if they are convincing to some, they are unlikely to be the outcome of the current political process. Second, recognition that the guidelines are impractical should inspire readers to think very hard about how such policies might be realizable in the future.

For these reasons, it is important to remember that these policy options should be considered as *goals to strive for* in the future. The intention of this work is to provide a vision of an end state that we might like to achieve, along with a rationale to justify that end state, because, if we don't know where were going, how can we ever end up there, except by chance.

In the next and final chapter, I suggest how the US could begin a transition towards implementing some of these globalization policy proposals. The US as the largest and most productive economy is one country that could withstand the adjustment costs and lead the world by example. Unfortunately though, whether the US could achieve such a policy adjustment is unlikely, unless, the current economic crisis builds up enough disillusion with the current system that a popular demand arises to strike out in a new direction.

[i] Rodrik (1997; p. 73) recognizes this problem when he says, "… the world is too complicated for first-best solutions, and realistically we will have to sacrifice some efficiency."

[ii] As Friedman (2002; p129) wrote, "Tariffs have of course been largely imposed to "protect" domestic industries, which means to impose handicaps on potential competitors. They always interfere with the freedom of individuals to engage in voluntary exchange."

[iii] It is worth noting that the effects involve more than just the domestic and foreign firm; domestic and foreign consumers and governments are also positively and negatively affected by the policy changes. This complication means that simple fairness comparisons – e.g. that their firm's actions have injured our firms, therefore it is fair to retaliate – are not as straightforward when one considers the full range of the effects.

[iv] According to a recent Gallop poll approximately 700 million people worldwide would prefer to live and work in another country. Of that 210 million would prefer to move to Europe while 165 million to the US. (See the Economist, December 17, 2009, http://www.economist.com/displaystory.cfm?story_id=15108697)

[v] Speech to the Labour conference, September 26, 2005.

[vi] London (2005) makes the argument that much of America's prosperity during the 1990s was really due to the advancement of competition in several key industries such as automobiles, steel (Nucor), telecommunications (AT&T breakup), finance and retailing (Walmart).

[vii] Lindert (2004) conducts a careful and detailed empirical analysis of the effects of social spending on GDP growth. The conventional wisdom is that there is an equity efficiency tradeoff, that should imply that greater social spending, tending to equalize incomes, would also tend to reduce GDP growth. However, Lindert finds that higher social spending has a negligible effect on GDP growth suggesting failure of the equity-efficiency tradeoff. This study is consistent with the engineering approach to policy making; namely if we can measure the efficiency effects of a policy then we can design an approach that satisfies society's concerns for equity and efficiency. This approach is problematic for all the reasons discussed in Chapters 2 and 3, and it is those deficiencies that inspire a quest for policy choice on the basis of sound principles.

[viii] See ideas at http://www.capitalism.org/faq/antitrust.htm