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

Chapter 7 - Involuntary Transfers

Transfer profit is a benefit received by one agent as a direct consequence of a comparable loss to another. With transfer profit, one party gains, the other loses equally; nothing new is produced. There is no surplus value accruing as with voluntary exchange. There are two variations of transfer profit. Involuntary transfer profit, discussed in this chapter, occurs when the losing party must suffer the transfer unwillingly or unknowingly. In contrast, voluntary transfer profit, discussed in Chapter 9, arises when the losing party makes the transfers willingly, as with charity or philanthropy.

Numerous types of economic activities and behaviors are manifestations of involuntary transfers. Some examples are obvious. However, many others become recognizable only after searching for it. In some instances involuntary transfers occur in isolation, while in other cases they are confounded with other interactions such as voluntary exchange. Sometimes involuntary transfers are abhorred by society, at other times they are defended as necessary to secure a fair economic or social outcome.

This chapter provides numerous examples of involuntary transfers to demonstrate that they are widespread throughout society and that its presence, whether actual or perceived, is the source of many economic and social complaints across the political spectrum. For example, when critics of globalization complain about the evils of profit seeking, when they argue that large multinational corporations are controlling the decisions of government institutions, when they openly worry about harmful labor market practices in developing countries, they are reacting to manifestations of involuntary transfers. Similarly, when free market advocates complain about the vast power of the government to transfer money away from people and control the decisions they can make, when they support management over labor unions, or when they support competition policies, they too are reacting to manifestations of involuntary transfers. Even the disdain for the ravages of war represents a negative reaction to involuntary transfers.

This chapter will highlight several distinct forms of involuntary transfer profit including theft, cheating and dishonesty, military conquest, exploitation, government transfers, anti-competitive practices, and externality effects. Some examples overlap with the globalization debate; those that do not will serve to illustrate the pervasiveness of involuntary transfers.

The presence of involuntary transfers has prompted the development of a variety of defenses. Often the defenses appear as moral codes that individuals are taught as they grow up. In many cases these same principles are codified into public law with proscribed penalties if violations occur. Finally, some defenses involve protections in the form of police and military forces. The chapter argues that all of these features of modern society are in place to defend individuals from becoming a victim to involuntary transfers.

Finally, this chapter will evaluate involuntary transfers in terms of the fairness principles discussed in Chapter 4. It is shown that involuntary transfers are unfair with respect to most of the principles. The one noteworthy exception is with respect to distributional fairness. Nonetheless the argument made here is that the concerns that pro-free trade groups have about some policies have the same fundamental foundations as the concerns of social justice groups have about other policies; both sides are reacting to perceived injustices, that is the unfairness of involuntary transfers.

Thievery, Cheating, and Corruption

The clearest example of involuntary transfers is theft. Whenever one person takes something without assent from another, the first person benefits at the direct expense of the other. Transfer profit via theft is always involuntary. This is the reason a thief will take property secretly, as with burglary; or will steal the item unexpectedly and quickly flee, as with purse snatching; or will threaten or resort to violence as with armed robbery. In the latter case, the use of force is intended to convince the property holder that resistance will lead to a much greater harm.

In the modern world, there are many creative methods used to transfer money from one person to another. For example, sometimes a person devises a way to electronically transfer money from one bank account into another. Other times someone offers to sell a good or service, but after receiving payment does not provide the promised item. Scams of this sort are commonplace around the world.

Theft via Imperfect Information

In other instances, thieves manipulate information in market dealings in ways that transfer money in their direction. In order for a competitive market to function the way it does in textbook examples, agents need good information. Accurate and complete information is important to consumers who need to know the prices as well as the quality of the products they purchase. For many products, a consumer can easily learn the price and quality. For other products though, both price and quality may be difficult to observe. Consider the consumer dilemma that arises with automobile repair.

When an individual's car begins to malfunction it is brought to an auto repair shop. The service the consumer wishes to purchase is a well functioning car at the lowest possible price. Initially though, neither the buyer or the seller knows which parts must be replaced and how much labor will be required to produce the intended result. Once the repair shop identifies the problem, an estimate for the total cost is typically provided to the consumer who can either accept or reject the offer. However, the consumer rarely knows the true nature of the problem, nor what it should cost to repair. Thus, the consumer is at the mercy of the seller because the seller has better information about the product than the buyer. Economists refer to this as a case of asymmetric information.[i]

It is easy to see how asymmetric information can lead to bad outcomes. If the auto repair shop is honest, there is no problem. It will provide accurate information about the source of the malfunction and will repair the problem at a price that covers the cost of production plus a reasonable profit. However, one can never be sure if the mechanic is honest. The best way for the consumer to be sure what is the true problem and a reasonable price for repair is to take the car to a second mechanic for another opinion (and hope the second mechanic is honest). Unfortunately, this step is time-consuming and incurs an opportunity cost. Therefore most consumers will usually accept what the mechanic suggests unless the estimate seems outrageous. Clearly though, since the mechanic has better information, it would not be difficult to add additional time and services to the customer's bill in order to raise up his own profit at the expense of the consumer. In this case, a dishonest mechanic can transfer extra money, or profit, from the consumer. Part of the transfer is for legitimate services, but some fraction is a pure involuntary transfer. In this example involuntary transfers are confounded with voluntary exchange.

A more significant example of using false information to generate involuntary transfers is the Enron scandal of 2001. In this case, a company that was touted as one of the most successful businesses in the country for five straight years by Forbes magazine suddenly turned out to be hiding behind a mountain of false information. The scandal involved continual misreporting of company profits in part by using creative accounting methods and in part through outright lies. As a result Enron was able to promote a rising stock value because a steady stream of investors were eager to participate in the good fortunes of a seemingly successful company. The success of the company during years of deception maintained the high incomes of the management team involved in the cover-up, but also contributed to rising wealth for the employees with retirement funds invested in company stock. However, the income generated and the wealth acquired was based on a lie. When the cover-up became known and it was learned that the profits were little more than creative accounting, investors rapidly divested leading to the collapse of the stock price and ultimately the company itself. Those most hurt were the employees who had most of their savings invested in company stock. Many were left with nothing.

The Enron incident is another example where involuntary transfers are confounded with voluntary exchange because at the same time the cover up was occurring, Enron continued to produce legitimate goods and services that generated revenues used to pay wages and profit to the stakeholders of the company. Thus, only a fraction of the profit generated by the company's operations was illegitimate; the rest arose from market exchange.

Bribery

In many countries, corruption in the form of bribe taking is rampant. In many cases bribery takes the form of involuntary transfers. In some instances, government officials may be empowered to grant licenses for certain privileges; for example, to obtain a building permit, or to import a good. By withholding these licenses, or forcing license seekers to wait, officials can extract money for procedures as simple as stamping a document. In this and many other situations government officials who act as gatekeepers can prevent certain activities from taking place unless involuntary transfers (bribes) are made to them.

Easterly (2001: 241-252) takes his readers on a tour of bribery and corruption around the world. He writes of the US beer owner who had several associates appointed to the Environmental Protection Administration (EPA) who thereafter eliminated restrictions allowing the beer company to legally dump toxic waste; Japanese businessmen who offered extravagant entertainment to government officials in return for a favor; the Ecuadorian President who had his agents obtain $3 million in currency for him from the Central Bank as his term expired; the Chinese businessman who allegedly diverted as much as $2.2 billion in public funds as kickbacks on construction projects; and the US company that allegedly paid the Philippine President $80 million to secure the contract to build a nuclear power plant.

Baker (2005) emphasizes that widespread cheating, tax evasion and corruption takes place in international business and within many governments. One example is cited in which IBM provided a bribe to top officials of Banco de la Nacion, the largest national bank in Argentina. For a $250 million contract to provide computers and services, IBM transferred $27 million dollars to foreign bank accounts held by these Argentinean decision makers to secure the business contract. Examples like this are extremely common and surely occur every day around the world.

Worker Exploitation

One major concern of many social justice advocates is the perception of widespread exploitation in the economic marketplace. Typically, multinational corporations are viewed as the principal exploiters, while the workers are the individuals being exploited. Exploitation is difficult to define and often seems to be in the eye of the beholder. However, true economic exploitation represents situations in which money is being involuntarily transferred from one person or group to another. This occurs for one or more of several reasons; if someone receives a lower economic return than is justified by his contribution to production; if the person is not free to voluntarily choose to participate in a market activity; or if a person is forced to endure degrading or harmful situations in an economic activity. In order for exploitation to occur there must be some degree of involuntariness. If not, one would need to explain why individuals would "choose" to be exploited.

One frequently cited example of worker exploitation occurs someone receives a lower economic return than justified. What is "justified" is often a subject of debate, however. Some people argue that workers have a right to a "living wage;" loosely defined as a wage sufficiently high to help a worker provide for himself and his or her family. To advocates of a living wage, market wages often appear unjustifiably low.

For example, many contend that large multinational corporations generate large incomes for the corporate elites and celebrity sponsors while simultaneously exploiting the vast majority of their work force by paying abysmally low wages. Evidence of exploitation is the fact that the ratios of CEO salaries to average worker salaries within US companies averages over 500:1.[ii] For many, this is sufficient to show that the powerful elites in the company are benefiting off the backs of the working poor.[iii]

However, before jumping to the conclusion that there is exploitation, we should look more carefully at the reasons why the wage differential is so high. Economists typically argue that the "justified" wage is the value of the worker's marginal product (VMP); defined as the value each worker contributes to production. This is the additional revenue the firm would earn if the worker works one more hour. In competitive markets, when firms maximize profit, a wage set equal to each worker's value of marginal product defines the profit maximizing and thereby the market-justified wage. Because of the very large supply of unskilled workers, it is possible that in some countries worker productivity is low enough to generate a low market wage. In economic theory, there is no requirement that the wage be sufficient to satisfy any particular standard of living. Many people appreciate this argument, but usually not to the degree of a 500:1 difference in CEO/worker earnings.

On the other hand, if workers are paid less than the value of their marginal product, then it is reasonable to claim economically that they are being exploited.[iv] There are numerous stories from developing countries about unskilled migrant workers being underpaid by withholding a percentage of wages from each paycheck. Sometimes workers will be promised a wage, but have substantial amounts withheld at payment time. Or, employers will postpone payment until long after work has been completed. If the worker quits the job because of the unfair treatment, he loses all hope of being paid. For the employer, there are usually other eager unskilled workers hopeful for an opportunity to work and who are unaware of the deceitful practices. Court systems in these countries are usually ineffective so that enforcement of contracts is weak at best and legal remedies rare. In addition, poor workers have few resources to engage in legal battles anyway. Thus, employers may be able to maintain a system of exploitative underpayment for a considerable period of time.

Another reason some observers see low wages as obvious exploitation may be a presumption that wages should be related to effort. Most everyone accepts that work requires effort and can cause disutility – work is often no fun! If people could acquire income without any work effort, most would give up work in a minute. The main reason to work is because it provides much-needed income to buy goods and services. Thus, wages compensate for the disutility caused by working.

To illustrate this point, imagine the average day of the CEO of a company like Nike Shoe compared to the average day of a worker on the production line of a Nike shoe factory in Indonesia. The CEO will spend his day in chauffeured limos, catered meetings, riding aboard corporate jets, dining in swank restaurants, most likely at the company's expense. This doesn't sound like there is much disutility from work at all. Of course, I'm leaving out the worries, concerns, anxieties, pressures, and heavy responsibility felt by the CEO, but those issues are also mostly ignored by critics of the system. In contrast, during a typical day, a factory worker will awaken early, eat simple homemade meals, commute via bicycle, bus or on foot, and spend the day in a hot noisy factory.

Clearly, the factory worker works every bit as long as the CEO. In terms of effort – the "hard" part of work – the factory worker might be thought to work even harder than the CEO. The amount of stress the worker faces may be as high or higher. And yet, the factory worker might receive only $4 per day for his efforts while NIKE's CEO Mark Parker received $4.16 million annually in 2006, which amounts to $13,800 per day.[v] What can explain this kind of inequity? This enormous gap in wages seems grossly unfair to many observers. If you don't accept that marginal productivity explains all of this difference, then you are left believing that the CEO is being paid way too much relative to the worker.

Exploitation is claimed largely because high incomes accrue to top management and shareholders while the poor factory workers, who, prima facie, appear like they are the one's mostly responsible for producing the "shoe" that's being sold, live in squalid conditions.[vi] Furthermore, the working conditions of the factory worker are sometimes unsafe, unhealthy and dramatically unpleasant in comparison to the corporate elites. On the basis of these assumptions, it would seem the top salary earners in the company are taking a disproportionately large share of revenue and leaving a disproportionately small share for the factory workers. It is as if they are "stealing" money away from workers. Indeed, it is widely believed that the corporate elites are "profiting" at the expense of low paid workers.

Which account is accurate is not important for the point being made here. The point is merely to argue that the prime objection to the actions of multinational firms in this situation is really a concern about involuntary transfers. Critics of multinationals believe that owners and managers are exploiting poor workers by taking too much of the revenue for themselves. Concerns about worker exploitation are simply a manifestation of a more fundamental concern about profit via involuntary transfers.

Private Anti-Competitive Practices

Competition in the market prevails when firm's owners, workers and others engage in mutually voluntary exchanges. This point will be discussed in detail in the next chapter. However, when owners or workers act to restrict competition, it also represents a manifestation of involuntary transfers. There are many different methods economic agents use to keep competition at bay; frequently it will involve government intervention.

Cartels

One method to restrict competition that does not require government help is the formation of a cartel. A cartel occurs when a subset of firms in an industry decide to coordinate their output and pricing decisions. Their objective is to restrict output and raise the market price, thereby allowing firms to achieve something closer to monopoly profit.

Economic theory clearly demonstrates the effects of cartel formation and monopolization. When firms successfully restrict output in a market they can raise their product price and achieve a much higher level of profit. Firm owners, and many other stakeholders in the firm, will thereby achieve higher incomes. However, consumers of the product will face a higher price. All of these consumers will reduce their demand; some of them to such an extent that they drop out of the market altogether. The higher prices paid by remaining consumers and the effect on consumption will cause each of them to suffer losses. When economists compare the gains to the firms with the losses to consumers, the losses exceed the gains leading to a reduction in overall economic efficiency. In other words, overall national economic welfare falls as a result of cartel formation.

Most notable for our purposes here though, is that cartel formation causes a transfer of income to occur from one group of people (consumers) to another group (producers). But is the transfer voluntary or involuntary? Two interpretations are possible. First, one could argue that the natural state of an economy is perfect competition and therefore the cartel arrangement involuntarily transfers income from consumers to the producers relative to the natural state. Alternatively one could recognize that in any voluntary transaction, both parties receive some surplus benefit. However, there may be no *proper* or *natural* distribution of the surplus between the traders. If this indeterminateness is accepted, then the cartel formation simply enables one party to capture a greater share of the surplus generated by trade. Since trades continue to occur voluntarily between producers and consumers, the new distribution of income does not represent an involuntary transfer.

Mergers

When two firms in the same industry merge to become a larger firm it is a step in the direction of monopoly and as such is an anti-competitive practice. There is a large literature in economics about mergers and much of it points to the potential for efficiency improvements that can arise because of fresh management, elimination of redundancies, and other reasons. However, in some cases mergers are clearly an attempt by one firm to eliminate a formidable competitor. Even if the two firms together are too small together to employ monopoly pricing, the merger will still temporarily reduce competition and improve the outcome for the acquiring firm.

Friedman (2002; p 26) discusses two possible interpretations for the term *free* enterprise. "What meaning is to be attributed to "free" as modifying "enterprise?" In the United States, "free" has been understood to mean that anyone is free to set up an enterprise, which means that existing enterprises are not free to keep out competitors except by selling a better product at the same price or the same product at a lower price. In the continental tradition, on the other hand, the meaning has generally been that enterprises are free to do whatever they want, including the fixing of prices, division of markets, and the adoption of other techniques to keep out potential competitors."

Mergers and firm acquisitions (M&As) occur all the time. In recent years, some major combinations included JP Morgan and Bank One, AT&T and Bell South, Glaxo Wellcome and SmithKline Beecham, and America Online with Time-Warner. As these company names reveal, some of them had also merged previously such as Time Inc. and Warner Communications. Although there are numerous rationales for M&As and while improved efficiency is one possible outcome, M&As raise suspicions that the prime motivation is to prevent competition. In many countries, M&As must be reviewed by a government agency to assure the combined company does not violate antitrust legislation. However, even though an M&A is approved, it is hard to imagine that the acquiring company won't be achieving at least some reduction in competitive pressures. Whether improved efficiencies that may result from the merger compensate for the temporary reduction in competition is something that would have to be evaluated case by case. Whether the anticompetitive effects of M&A are significant or whether they are relatively minor is also something we don't know. Nevertheless, regardless of the long term effect, any reduction in competition may lead to higher prices for consumers of the product and thus may represent involuntary transfers from the consumers to producers.

Labor Market Practices

Actions to prevent competition through the formation of cartels is not limited to output markets; similar practices are also undertaken by workers, arguably in response to unfair or exploitative practices by owners and managers. The formation of labor unions to engage in collective bargaining raises the bargaining power of workers vis-à-vis the owners. Just like before, one reasonable interpretation is that collective bargaining simply allows workers to obtain a greater amount of the surplus that arises in every voluntary exchange. For example, suppose workers are willing to work for a firm for any wage greater than \$8 per hour; at a lower wage they would walk away and look for other employment. Suppose the firm is willing to pay workers a maximum of \$12 per hour. Anything higher and the employer would stop hiring. This means that there is a range of wages that would make both parties willing to enter into exchange. A labor union will attempt to bargain for a larger amount of the surplus. The result may be a contract with a wage at \$11.50 per hour rather than \$8.50.

This example is NOT an instance of involuntary transfers though. Instead it is simply a story about effective techniques to establish distribution of the surplus. However, collective bargaining techniques can become anticompetitive and lead to instances of involuntary transfers.

Consider a case of a labor union that forces workers to be members and pay dues. The inability to opt out of the union creates an involuntary element to the arrangement.

Also, since restricting union membership also reduces firm labor supply, the union could effectively force up the wage. This action is analogous to cartel behavior by firms in the output market; only here the action occurs in the labor market. In this case, by artificially restricting supply, the union members are able to shift a greater amount of the surplus away from the owners. Involuntary transfers occur because the losers, the firm owners and the workers who cannot gain access to the union, are made worse off involuntarily.

In a similar vein, professional licensing requirements are put into place ostensibly to maintain higher quality standards for workers in these professions. For example, the legal profession requires lawyers to pass a very difficult bar exam in order to practice law. The medical profession requires doctors to pass a series of tests in the US to be qualified to practice medicine. Of course, these standards assure that the best test takers will become qualified to practice law and medicine, and it is quite likely that on average the better test takers know more and will perform a higher quality service. However, at the same time, it is clear that if standards are kept high enough, they can also serve as an effective barrier to entry in these professions. If this occurs, then voluntary exchanges are prevented, prices are pushed higher in the marketplace and the certified professionals gain transfers at the expense of consumers.

These practices are often controversial. Some people are opposed to labor unions and to strict licensing standards. I suggest that these objections arise from the suspicion or belief that the activities are allowing organized groups to take advantage of others by achieving involuntary transfers. Once again, determining the appropriate policy prescriptions can be difficult because voluntary exchange (providing quality services to consumers) is confounded with involuntary transfers (restrictions on open competition to sustain higher quality). For now though, the purpose here is only to suggest that, to the extent that labor market practices such as labor unions or licensing standards are anticompetitive, they represent examples of involuntary transfers.

Government Sponsored Anti-Competitive Practices

Private attempts to restrict competition via cartels, mergers or unionization often fail. This is because the presence of additional profit either stimulates cheating by the participants or the entry of new firms and workers. Some believe that this market response is sufficiently strong that there really is no need for competition policies because the market itself will automatically and eventually revert to free competition. Perhaps because of this reality though, firms also recognize that while private actions to restrict competition may fail, government interventions to restrict competition can often be very effective. There are numerous ways this can occur, some of which are discussed below.

Indeed as Epstein (2003b) notes, "the creation of the state poses risks of the very evil that it is supposed to negate. … governments are not only good at protecting the goods and services produced by ordinary individuals. Often they are adept – too adept – at shifting opportunities, advantages and property from one group to another, especially by allowing political majorities to control the destinies of the minorities that live under their rule." Frederic Bastiat (1998; p7) wrote more forcefully, "It is impossible to introduce into society a greater change and a greater evil than this: the conversion of the law into an instrument of plunder."

Import Tariffs

Consider the case of an industry facing competition from foreign imported products. When imports flood in, domestic firms must adjust quickly to the new circumstances or face decline and possible closure. A common response by the import-competing industry is to lobby for increased protection in the form of higher tariffs.

In a simple model, a tariff will protect the domestic industry by raising the local price, thus helping the industry to maintain output, profit and employment. If not too high, the tariff will also increase government revenues. Thus, the workers and owners in the protected industry and the government budget will gain from the tariff. However, the domestic consumer of the product will have to pay a higher price. Consumers will reduce purchases, pay the higher price and subsequently have less money to spend on other things. In other words their real income will fall because of the tariff.

Government interference in the market in this case is clearly an anti-competitive practice; a tariff reduces foreign competition. Indeed, the action is called *protection* because it protects the earnings of the import-competing firms. Since the industry seeks higher income than is possible without government intervention, the solicitation is known as rent seeking. In a broader sense though, the effects of a tariff amount to money being taken away from some people and given to other people, albeit not directly. Some individuals in the industry and some government programs receive more income, while all domestic consumers of the product receive less. Since those who lose from the policy either are unaware of the losses they incur and/or have little to no ability to influence the decision, the action is a form of involuntary transfer profit.

Agricultural Subsidies

Another example of government intervention with an anti-competitive effect is the use of agricultural subsidies and support programs. These payments, made by governments to support farmers, reduce the effective cost of production and make it possible for many, otherwise inefficient, farms to remain viable. For efficient firms it provides a boost in income as well. The policies cause the domestic price to increase effectively transferring money away from the consumers of agricultural goods and taxpayers who must pay for the subsidies, towards the farmers. For the same reasons outlined above, it is arguable whether these transfers are involuntary, but given that taxpayers and consumers are not allowed to opt out and since there is widespread opposition to these subsidies, clearly many people view the subsidies as involuntary.

Several arguments are used to justify these policies. Most notable are the desire to maintain secure domestic food supplies for national security reasons. Income supports also help to smooth out the price fluctuations that are common in commodity markets and thus fulfill an insurance role. Finally, it is argued that because foreign agricultural industries are heavily supported, domestic interventions are necessary to level the playing field. Nevertheless, the relevant question is whether these concerns justify the involuntary transfers generated by government intervention.

Market Externalities

Although most economists tend to believe in the benefits of an unfettered marketplace, most will also accept that government interventions are justifiable in certain circumstances. One such circumstance is when market externalities are present. As explained in some detail in Chapter 3, an externality arises when the economic activity of one agent, be it a firm or a consumer, has an impact on the well being of another person *external* to the original market activity itself. The classic example is pollution. When an industrial firm pollutes the air and water in the vicinity of its factory, the people who breathe the air in the local community and use the river downstream may be negatively affected. However, these negative effects are not a part of the production and consumption activities in the market for that product. If firms that pollute do not take into account these negative effects on others, economic theory teaches that firms will over-pollute relative to what would be best from a wider social perspective. In this case, government implemented restrictions on the firm can serve to reduce the negative external effects and raise economic efficiency and social well being.

Many other types of externalities are well known. Although many arise from production activities, some arise from consumption too. For example, the consumption of gasoline in consumer automobiles causes air pollution in the community, a negative effect upon others. Some externalities are positive in their effect. Thus, when a firm conducts R&D, some of the knowledge it acquires for its own use may nonetheless spillover into applications in other industries. External industries may acquire the useful knowledge via channels as simple as bar room conversations between researchers from different firms.

Positive externality effects transfer benefits to another individual or group and as such are not objectionable. Nevertheless, the creator of the externality, because there is no monetary return for the positive effects, is likely to under produce the product relative to what is optimal from a social perspective. In these cases, government subsidies can be used to achieve a more desirable social outcome.

Negative externalities, however, ARE objectionable to the person or group that is negatively affected. These effects are unintended byproducts of production or consumption activities. Typically, the creator of the external effects is not maliciously trying to harm others in order to benefit himself. However, the creator may be reluctant to prevent the external effects for several reasons. First of all, the negative impacts may not be felt immediately. If an industry dumps toxic chemicals in a nearby field, it may take years before it begins to affect the groundwater. Secondly, it will be costly to prevent the negative effects. Installing pollution abatement technology can be very expensive. If these costs are high enough, and especially if the negative effects become known only much later, the firm would not wish to suffer a reduction in profit to produce in a cleaner manner.

Nonetheless, because the polluter's costs would be higher if the product were produced in a way that caused no negative external effect on others, it is reasonable to claim that a part of the polluter's profits are related to the losses incurred by others. As such, negative externalities like pollution are an example of involuntary transfers.

Military Conquest

Offensive military actions can be thought of as theft on a grand scale since it involves one group forcibly taking control of the possessions and even the individuals from another group. As mentioned in the last chapter, when pre-historic societies began to produce surplus food and valuable tools, it became possible for other human groups to acquire what they needed to survive by forcibly taking (i.e., stealing) from other people rather than taking from nature and producing things for themselves. As human civilization grew, so did the resources devoted to build weapons rather than tools.

Thus, military conquest is a notable and historically widespread example of involuntary transfers.

Historical writings sometimes celebrate the accomplishments of great military leaders. But, consider the economics of military conflicts. In particular, think about all of the individuals involved fighting these battles and wars; they all require food, clothing, shelter, and military equipment to support and sustain them. As populations grew, the sizes of the armies also grew. Alexander the Great's army had as many as 40,000 men. Genghis Khan had an army of over 100,000 men. Napoleon invaded Russia with over 500,000 troops. During these campaigns, the soldiers are not actively engaged in any productive activity that creates food, clothing, shelter or military equipment. Thus, to sustain themselves, armies require resources that must be taken from somebody else. In ancient times, the conquering armies raided the stockpiles of food, clothing and equipment from the towns and villages that were overrun. Armies were notorious for taking other things besides goods; including taking people into slavery or servitude and the rape of women and children. When supplies ran out, an army could simply move on to another town or village whose surplus supplies had not yet been plundered.

In modern times, armies are supported by government expenditures, which is available because it has been transferred from taxpayers. Taxes come from the incomes of people who have produced something. Had taxes not been paid, these individuals would have spent the money on other goods and services. Instead, when taxes are paid, this consumption is shifted and used for military purposes. Thus, in these situations, goods, services and other benefits are transferred from one group of people to another. Thus, offensive military endeavors are clear examples of profit from transfers.

Whether the transfer is voluntary or not depends importantly on one's perception of government programs. In a democracy, are taxes paid voluntarily because the populace has voted for representatives who in turn have collected taxes to pay for the military? Or, are the taxes involuntary because a refusal to pay may land one in jail? This issue is discussed later in this chapter and in Chapter 9.

Defensive Responses to Involuntary Transfers

Examples of involuntary transfers, including the simple and obvious ones like theft, to more obscure examples like negative externalities, highlight the many ways that one group of people can benefit from the losses of others. In most instances, the losers, or victims, of these actions do not generally sit back and endure the losses unless the effects are well hidden. Instead, a sizeable number of defenses have arisen to protect people from the losses arising from involuntary transfers.

For example, a variety of strategies are used to defend against personal injury. Self-defense techniques provide the wherewithal to repel an attacker. Mace, pepper sprays and brass knuckles can have a similar effect. The right to bear arms and own guns in the US has been justified throughout history as a necessary measure to assure protection for people. Bank tellers, Presidents of countries, and the Pope are all protected with bullet-proof glass.

To protect personal property from theft, people install locks on doors and windows and place valuable possessions inside safes. Fences and gates are used to prevent entry to personal properties. Security guards are hired to protect businesses, and residential communities. Finally, police are trained and mobilized in communities to protect against loss of property and injury to people. To empower the police, laws have been established allowing police to detain persons suspected of crimes against others and establishing procedures for verification and punishment of those caught injuring others and stealing property.

The threat of attack from other countries creates a demand for a national defense to protect, not only possessions, but also the nation's freedom and culture. Thus, countries maintain standing armies; build tanks, fighter jets, and aircraft carriers; develop nuclear and biological weapons; and set up espionage agencies to monitor the behavior of suspected individuals and countries.

There are a variety of defensive responses to other forms of involuntary transfers as well. States have established numerous laws to prohibit fraud, corruption and bribery. States attorneys are typically empowered to investigate and prosecute individuals and businesses accused of violating these laws. Punishment, if caught and convicted, may serve as a deterrent.

Laws are also in place to prevent the misuse of information; businesses are not allowed to falsely advertise or make unsubstantiated claims about their products; securities brokers are not allowed to take advantage of insider information; and public companies are not allowed to falsely represent their business accounts and must submit to periodic audits for assurance purposes.

Other laws are put in place to mitigate concerns about worker exploitation. Minimum wage laws, occupational health and safety standards, and even prohibitions against slavery and indentured servitude, are all intended to prevent, at least to some degree, involuntary transfers.

Finally, some involuntary transfers that arise due to anticompetitive behavior also have legislation against it in many countries. Antitrust laws, and the necessary clearance for mergers, both serve to check monopoly formation. Even free trade areas and the agreements reached under the WTO, by helping countries to commit to freer trade policies, also helps assure a lower amount of involuntary transfers achieved through government policy.

Defensive Responses as Involuntary Transfers

Defense generates well-being because it reduces the fears and anxieties that arise because of the possibility that theft, personal injury or other involuntary losses may occur. Because defensive goods and services are produced and purchased in the marketplace, we could think of these as an example of voluntary exchange. However, defensive goods and services themselves are demanded only because of the threats that are posed by others. In the absence of these threats - that is, in a perfect or ideal world - people would not demand these goods and services. Thus, we can think of the demands for defensive goods and services as being indirectly involuntary.

Using theft as an example, when a thief robs someone at gunpoint in a community, knowledge of the crime within the community raises the possibility in their minds that they too may become a victim in the future. That fear generates the demand for defensive goods and services. Since the thieves create the fear, thieves are also responsible for the existence of this market activity. In other words, the behavior of thieves generates a negative externality effect. For this reason, the demand for defensive goods is ultimately involuntary; people are forced into it by the potential actions of others.

The purchase of defensive goods and services also incurs an opportunity cost that is different than the cost of other goods. If less defense, or in the extreme no defense, were necessary, then the time, effort and resources that went into the creation of defensive goods and services would be available to produce what might be called primary goods and services; that is, goods and services that are demanded because the goods themselves provide well being. Primary goods are things like, food and clothing, automobiles and refrigerators, hotel and entertainment services.

Who incurs the opportunity cost, and thus who loses, depends on the way defensive goods are financed. For personal or private protection, individuals self-finance by allocating some portion of their household or business budgets towards alarm systems, security guards or gun purchases. Consequently, they forgo the purchase of other things. In this way they suffer a loss in comparison to the ideal circumstance in which no defensive activities would be required. Of course, in comparison to the true state of the world, in which fear of involuntary transfers is real, the defensive expenditures are worthwhile and this is why they are made. Nevertheless, even self-financed defensive expenditures qualify as an example of involuntary transfers. The winners in this situation are the successful perpetrators of involuntary transfers (i.e., the thieves), as well as those who benefit from the production of defensive goods and services.

The second method to finance the purchase of defensive goods and services is via the use of public funds. Tax revenues finance law enforcement agencies and provide for a national military defense. Taxes also finance the judicial system and agencies whose purpose is to enforce contracts, protect private property, and prevent anticompetitive monopoly formation. As with private financing, these expenditures incur an opportunity cost. In this case the cost is borne by the taxpayers who must forgo other (primary) goods and services. The redistribution, or involuntary transfers, occurs between taxpayers (who presumably do receive the benefits of protection just as with private financing) and the providers of defensive (secondary) goods and services.

With defensive goods provision there is a notable difference with previous examples of involuntary transfers; namely the receivers of the benefits are not the agents causing the transfer to take place. While thieves, in the simple example, do benefit from the crime, additional benefits accrue to the providers of defensive goods. This can generate some additional negative effects.

Recognizing that defensive responses to many forms of involuntary transfers are inevitable because the threats will never disappear entirely, the transfers that arise here also cannot be avoided. However, the *level* of defense that is provided can be affected by manipulating information. If the probability that an incident like theft will occur is perfectly known then, in a private context at least, one could calculate an acceptable amount to spend for defense. However, when the probabilities are unknown, or when taxpayers finance the cost, it is conceivable that defense is overprovided. Here are two plausible examples.

First of all in a private setting, a security firm selling residential alarm services might exaggerate the threat of burglary in its advertisements in order to raise community fears and secure larger sales. Although, the defensive expenditures may be wanted and needed by potential victims to a certain degree, a customer might nonetheless wind up with a much more secure house and have spent much more than true information might have warranted. In this case the security firm is eliciting greater than the appropriate amount of involuntary transfers.

A more extensive problem of a similar nature might be apparent in the size of defense expenditures in many countries. Although a national defense is perhaps worthy of considerable expenditures and while most taxpayers have no problem, in principle, with making contributions, international security threats may be overemphasized by those who stand to benefit from the defense spending. Back in 1960, US President Eisenhower warned of the growing influence of the "military–industrial complex." Since then, military expenditures continue to grow while many critics regularly contend that defense firms themselves are responsible for a considerable amount of unnecessary spending. To the extent that national security fears are exaggerated, or when defense firms use their lobbying clout to elicit greater than necessary transfers, involuntary transfers are also greater than necessary.

Fairness and Involuntary Transfers

With respect to the fairness principles, involuntary transfers are mostly unfair. Involuntary transfers occur whenever one person or group gains at the direct expense of another person or group. While the most common examples are theft, offensive military incursions, corruption and fraud, involuntary transfers also occur in the minds of some observers, when governments tax its citizens.

That an involuntary transfer, such as theft, is unfair is easy to see vis-à-vis the fairness principles. First, it clearly violates positive reciprocity fairness since the transfer involves a gain to one person and an equal loss to another. There is no positive reciprocity whatsoever. Second, due to the defense mechanisms that are usually inspired to ward off involuntary transfers, the net effect is more likely to be negative than zero. This implies that involuntary transfers are not fair in terms of maximum benefit fairness.

In terms of the golden rule, involuntary transfers are not something one would wish others to do towards oneself so it is not fair on this basis to transfer or take something away from another. In terms of privacy fairness, the person who has something taken away - the victim - has not done anything to the perpetrator and thus the victim's privacy is clearly infringed. Finally, with respect to nondiscrimination, although the victims of involuntary transfer can be anyone, it is more likely that those who suffer losses are more vulnerable in some respect. Either the victims are relatively weaker or less educated or older and more frail than others. In these situations, involuntary transfers do tend to discriminate and is unfair on this account.

The tendency for involuntary transfers to occur to certain weaker groups often provides a justification to use similar transfers in reverse. Thus, if someone believes that the income inequality in a country is mostly due to powerful groups exploiting its weaker citizens, then one might favor a government sponsored redistributive effort. By using progressive taxes, societies can transfer income from the relatively wealthier to those whose incomes are lower. In this way involuntary transfers can be used to equalize incomes in a society and thus might be considered fair from that perspective.

Also, although the laws or regulations calling for punishment of those who commit involuntary transfers will generally conform to negative reciprocity fairness, the transfer activity itself is not fair with respect to negative reciprocity since there is no balanced reciprocal action. Nevertheless, for those who believe that involuntary transfers in the marketplace have created exploited victims who have suffered losses as a consequence, one can argue that causing reciprocal losses to the relatively wealthy via progressive taxation is fair with respect to negative reciprocity.

Table 7.1 offers a summary of the fairness characteristics of involuntary transfers. Note that involuntary transfer profit is mostly unfair with the exception of possible redistribution schemes like progressive taxation that can mitigate distributional fairness concerns.

Table 7.1
Consistency of Involuntary Transfers
with Fairness Principles

Distributional	Yes and No
Nondiscrimination	No
Golden Rule	No
Positive Reciprocity	No
Negative Reciprocity	No
Privacy	No
Maximum Benefit	No

Conclusion

In summary, involuntary transfers, in its most egregious form, such as with outright theft, is easy to characterize as unfair and most people would probably accept the interpretation. Involuntary transfers are unfair in terms of privacy fairness, reciprocity fairness, the golden rule, maximum benefit fairness and nondiscrimination fairness. However, other occurrences of involuntary transfers, as with progressive taxation, (which again we could argue as to what portion of taxes is involuntary) can be characterized as fair with respect to distributional fairness and negative reciprocity.

Involuntary transfers appear to be the root cause of virtually all claims of injustice. People react sharply and instinctively against anyone else seen to be profiting by taking something away either from themselves or from someone they care about. One problem we face though is that every group sees involuntary transfers in different places and in different intensities.

Some people see involuntary transfers in exploitative wages and horrible working conditions of some workers in some places. They believe that the high income earners in those industries are taking advantage of its often unskilled and uneducated workforce. Other people see involuntary transfers in the taxation policies of governments who take money away from its citizens coercively. Some see involuntary transfers when pharmaceutical companies maintain high drug prices in developed countries and use their political clout to prevent importation of cheaper substitutes. Other people see it when immigrants illegally enter a country and take away jobs from its citizens, commit crimes, or receive government-financed benefits. Some see involuntary transfers when foreign firms purportedly dump their products on foreign markets in order to achieve monopoly advantages in the future. Others see it when some countries violate their commitments made in the WTO and gain an advantage over other countries. Some see involuntary transfers when multinational firms disregard the environment and fail to protect endangered animal species. Others see it when a government writes rules and regulations that give advantages to some firms over others. Lastly, some see involuntary transfers when a country engages in military conflict with another.

While the complaints about policy choices on both sides can be attributed to reactions to involuntary transfers, both sides also tend to advocate involuntary transfer methods to correct for other economic problems. This leads to an inconsistency. For example, social justice advocates often promote redistributive policies such as minimum wages and higher corporate profit taxes. For supporters of these policies, government is supposed to regulate markets to achieve more desirable results and thus it is considered acceptable policy. However, free market advocates often see these same policies as infringements on the freedom of private markets.

On the other hand, some who oppose taxation policies on grounds of inequity, may also accept certain protectionist policies like antidumping that protect domestic firms from 'so-called' unfair foreign competition. They might also accept selected industrial policies to promote national security via farm or technology subsidies and to promote intellectual property right protections. However, these policies also use the power of government to restrict free market exchange and facilitate the involuntary transfers from some groups to other groups.

In the next chapter, we'll consider the manifestations of voluntary exchange in market economies and investigate the effects if free voluntary exchange is allowed to prevail. We'll also consider the fairness properties of voluntary exchange. The chapter will argue that while voluntary exchange will generate some unfavorable effects, it is also shown to be mostly fair with respect to the fairness principles.

[i] See Callahan (2004) for a description of the Sears auto repair scam.

[ii] Herbst, Moira, The Costco Challenge, Labor Research Assn., http://www.laborresearch.org/story2.php/391

[iii] Friedman (2002; 167) writes that "Marx argued that labor was exploited. Why? Because labor produced the whole of the product but got only part of it; the rest is Marx's 'surplus value.'"

[iv] Frank (1985) argues that workers are not paid the value of their marginal product in developed countries. Instead, low wage workers tend to be paid "too much," while higher paid workers tend to be paid "too little." Frank accounts for this discrepancy by noting that individuals have a desire for status and that one way to pay for the status conferred by higher wages is actually for high wage workers to bribe, or transfer money to the lower paid workers. This account contradicts the typical worker exploitation story since in this case it is the high paid workers who are being paid less than their VMP.

[v] Assuming a 50 week, 6 days per week work schedule. Salary info from Forbes.com (http://www.forbes.com/lists/2006/12/X0NY.html)

[vi] In truth the shoe consists of much more than merely the physical product. The customer is also paying for transportation, insurance, advertising, packaging, retail service, new product development, and much more.