

TRANSITIONAL GAINS AND TRANSFERS

Gordon Tullock

Information Costs and Transitional Gains from Oil

I recently visited Alaska, which had an unusual problem, a problem in fact that it shared only with such places as Saudi Arabia and the Trucial States. The problem was government revenue far above any conceivable direct government expenditures. In all three cases this revenue came from oil reserves, which were confiscated in the case of Saudi Arabia, and in the case of Alaska subjected to a high fee.

When Alaska began to consider this windfall, the state first decided simply to distribute it in cash to Alaskans. It then occurred to them that since any American has a perfect right to move to Alaska, the net effect would be a large in-migration. If the state had gone through with this procedure,¹ there would have been a period of time in which Alaskan natives were receiving large sums of money, and people would have been pouring into Alaska. As the people poured into Alaska the per capita payments would have gone down,² and the return from labor invested in productive activity in Alaska would have fallen sharply because the people who had moved in expecting this payment would be willing to supplement their income by working at very low wages.

At the same time, of course, the returns on rental real estate in Alaska would rise very sharply, and various industries that received this influx of cheap labor would probably become extremely profitable. Adjustment to all of this might take many years. Indeed, if

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The author is Holbert R. Harris University Professor of Economics at the Center for the Study of Public Choice, George Mason University.

¹I think the proposal was sensible, even if it would have the in-migration effect. Alaskans do, in fact, receive a small annual payment, but very much less than the value of the windfall.

²Of course, the deterioration of the cartel would have had the same effect.

people contemplating moving to Alaska thought that the cash payments would not continue indefinitely into the future, and hence discounted the prospect of the payments terminating against the quality of life in what is, after all, not the most pleasant of American states, it is likely that the original inhabitants would have a permanent net transfer to them, equivalent roughly to this risk premium plus the cost of moving for citizens of the lower forty-nine. Still, the really big gains would have been in the early days and would have been only transitional. In practice, and I shall return to this below, it was decided to use the money for purposes that on the whole were a good deal less valuable.

Saudi Arabia and other Arab participants in the oil cartel did not have this problem, since they are not required to permit noncitizens to immigrate. Various American Indian tribes³ were likewise permitted under U.S. law to particularize the entire benefits of oil revenues to their own members. A given tribe that decided to enter into a contract with an oil company for the exploitation of its tribal area or that was compensated by either the U.S. government or the state of Alaska for land taken over could have simply distributed the money among its members. There does not seem to be any evidence that they even contemplated this particular simple and efficient solution.

I have an acquaintance who was an ambassador in Arab areas and who speaks excellent Arabic. He was discussing with me the economic situation in one of the minor Arab states and remarked that they had a revenue so large that there was no conceivable way of making use of it. Actually there are many ways, but the one I suggested to him was simply paying it out to the subjects of the sheikh.⁴ It was clear that he had not previously thought about this, and certainly none of these governments seems to have contemplated it. The Alaskan government did give some thought to the matter, as mentioned, but decided against it.

It seems to me that direct payments out would have been a sensible thing to do, but because the profits of the oil would come as an income stream over time and this income stream in the future was of necessity rather uncertain, the distribution of a current property right to some particular share of future incomes would no doubt have been preferred by the citizens of Saudi Arabia or Alaska to the direct cash payment. Further, by making this distribution immediately, the prospect of in-migration to Alaska would have been sharply reduced.

³Sometimes called original Americans, although, as a matter of fact, they seem to have arrived after Folsom man, and to have killed him off.

⁴In practice, it was very largely paid out to the family of the sheikh.

Thus each Alaskan citizen could have been given a transferable certificate permitting its owner to receive one one-hundred and fifty-seventh thousandth, or whatever is the correct number of the future oil royalties received by the state of Alaska. In the case of the Arab countries, it would have been even simpler to incorporate the new nationalized oil companies and give shares to their citizens. Some arrangement to make certain that the cartel remained intact would of course be desirable. It seems likely that a private corporation owned by the citizens of the various Arab countries would have been a more efficient way of handling this problem than OPEC.

In all of these cases, it would have been possible to arrange so that the transitional gain made by the beneficiaries of these very large transfers was indeed the whole potential value of the OPEC cartel.⁵ But that is not what happened. In fact, the gains received by the average citizen of Alaska, or the average member of an American Indian tribe in Alaska, are much lower than the potential profits. The same is true with respect to the Arab states, although in this case the ruling classes have done very well. Nevertheless, the amounts they have received are very much less than the present value of the cartel at the time it was organized. There have been immense wastes.

Further, it seems likely that in all of these areas, by now, no one is actually making any gains. The Arab prince is probably now making about the same return on his rights in Saudi Arabia as he is on his investments in South Carolina farm land, if we discount properly for the relative riskiness of these two investments. He received very large gains originally, and the bulk of these he has kept in the form of investments, whether in the form of bank accounts in Zurich or retaining his rights in Saudi Arabia which he could have unloaded, albeit, they were not subject to ordinary sale transactions. Disposing of them in return for further investments in, say, Portugal, would have involved a political rather than a purely commercial transaction. Nevertheless, it was possible.

Thus, very large potential gains were in fact sacrificed by the "owners" of these potential transfers. The reason seems to have been largely *information difficulties* that prevented them from realizing just how wealthy they were. They turned to expert advisors like my friend, the American ambassador. These expert advisors were, first, not very expert and, second, heavily biased toward spending the money in some way other than simply enriching the Arabs or the citizens of Alaska.

⁵The Alaskans would, of course, have made something out of their oil even without the organization of OPEC, but much less.

Winners and Losers under Alternative Transfer Schemes

In general, the experts developed systems under which the money would go to some kind of "development" in the area. In some cases, this "development" went into direct investments in nonoil resources, which at least in theory were going to be around after the oil was exhausted. My guess is that the investments are not very good, and hence the returns will not be great. There is, for example, a building in downtown Juneau that is the headquarters of the corporation of one of the Indian tribes. The corporation exists to invest the tribe's ill-gotten gains. I am sure the executives of the corporation will do reasonably well, but it is not obvious that anyone else will.⁶

This is characteristic of most of the redistribution methods that I have described. The "technical" personnel who are involved in advising and making use of the funds have normally obtained for themselves an increase in income. In the case of the Saudi Arabian example this increase in income has been very great indeed. In Alaska it is probably quite modest, with civil servants being paid more and there being more of them than there were before, but no giant gains.

Practically no one, when asked how this money should be spent, suggests simply distributing it to the citizenry. Another possibility, of course, would be distributing it only to the poor. Alaska does not have very many but there is no constitutional barrier preventing the state from distributing its money to poor people outside Alaska. One would think that the average left-wing intellectual would be in favor of such a distribution, but so far as I know, it has never been suggested. The end product of all of this is that most of the funds available from these particular large transfers were wasted, and many of the potential beneficiaries are probably not even aware that they are being mulcted.

Why is this money then used either to simply expand what we might call normal state activities or to cut taxes, and not directly paid to the citizenry? Clearly the citizens would be better off. Further, the king of Saudi Arabia would be better off if he had not decided that, in addition to paying off his family and various friends, he would undertake a fairly major development project in an area that is probably as resistant to development as any in the world. Clearly, if the

⁶Since writing the above, I have seen reports of the financial problems of the corporation. It just proves that social scientists can predict.

development money had simply been paid out to the tribesmen, they would have done much better in terms of personal security and avoiding revolution than under the present arrangement. One would think that expenditures on secret police and armies also would be highly attractive, but only a small part of the oil revenue has been invested in such matters.

Note in particular that the expenditures in, say, Alaska for improving state services and reducing regular taxation are in general ultra-marginal. That is, the services now provided would not be provided by the citizens if they had to pay for them in a more direct way. They were willing to pay only their previous tax rate for the previous services.⁷ Thus, the money is being spent on things that are of less value than the money itself. Of course, the citizens now have a somewhat different income position than they had before, but in fact, the effect has been fairly minor granted the way the money is being spent.

The gains were transitional rather than permanent. If the expenditures have any benefit they will attract immigrants into Alaska to share in the gains, until such time as migration to Alaska and life in Seattle are equivalent. Of course cash would bring in many more people, but there is no obvious reason why the current citizens of Alaska would be deeply distressed by that. The state is so large that those who want privacy can easily find it even if the population goes up by several million.

If we consider the problem from the standpoint of the civil servants who are called on to advise, the transitional gains may be quite substantial. Their wages are raised, and as civil servants they can hardly be fired even if more civil servants are brought in at the new wage rate. Thus, bringing the whole matter into true equilibrium might take a full generation, and they would achieve transitional gains during that entire period.

If we consider the intellectuals who, generally speaking, tend to favor this kind of thing, it is hard to avoid the impression that they are simply making a mistake. That would not be true, of course, of intellectuals living in Chicago who would not gain from anything going on in Alaska. But one would think that newspaper reporters on Alaskan newspapers would prefer direct payment of cash to increases in the state services. It may be in this case, however, that the intellectual community was so small that they were completely dominated by intellectuals elsewhere. The intellectuals elsewhere would not I presume be terribly happy about direct payments to

⁷Insofar as the voting process measures these two factors.

citizens of Alaska, whereas they might be strongly in favor of, say, government-sponsored housing there.

The latter explanation also might apply in Saudi Arabia, which had practically no intellectuals with any economic background. Intellectuals from the outside, like my friend the ambassador, would not have gained from any direct cash payment, and in the United States tend to be vaguely in favor of various government projects. They can transfer that vague preference to the Trucial States by way of bad advice at no cost to themselves.

So far, I have discussed this particular, very pleasant transfer entirely from the standpoint of the beneficiaries. It is notable that most of the losers did not seem to think there was anything much they could do about it. Further, they had a strong tendency to blame the wrong people.⁸ That there were very real and very large effects on the victims is of course true, and it is also true that these effects were larger than the benefits that the recipients would have received if they had taken it in straightforward cash.

This is of course characteristic of most transfers by government. In this case, successful efforts on the part of the oil consumers in the United States to reduce the transitional cost of the organization of OPEC increased its total cost over time to those same consumers. Indeed, it is not positive that OPEC would have been able to remain in existence if the price control had not been slammed on retail gas expenditures at the beginning. Peculiar circumstances in which wealthy Texas oil men were compelled to subsidize the import of OPEC oil provided an additional market for the cartel, which may have been necessary for its stability.⁹

⁸In 1973, I spent some time in Pittsburgh and read the local Pittsburgh paper. Almost everyday, the paper had two leading stories. One story was invariably an account of OPEC meetings and OPEC ministers' decisions about prices, production, etc., and the other an attack on American oil companies for raising oil prices. The probable reason for this was not entirely muddle. The voters could do something nasty to the American oil companies without violating their own moral code. A naval expedition up the Persian Gulf, although a trivial military activity, would have appeared to them to be imperialistic and wicked and hence they were not going to think about it. For another account of somewhat the same phenomenon, see Olmstead and Rhode (1985).

⁹Public misunderstanding was extreme. Byers and Fitzpatrick (1986, p. 43) say, "Throughout the protracted energy problems of the 1970s, Americans doubted there was a real oil and gasoline shortage stemming from a genuine depletion of natural resources. They believed that the oil shortages were contrived—a conspiracy manufactured by large oil companies." Notably, Byers and Fitzpatrick also do not seem to be aware of OPEC's role. The long delay imposed by the environmental movement on the trans-Alaskan pipeline was almost certainly also important. If it had come into production at its originally planned capacity and date (1973), it is dubious that the Arabs would have even tried to organize the cartel. Possibly those environmental lawsuits were the most expensive that have ever been filed anywhere in the world.

But these are what we might call pleasant transfers. The beneficiaries of the transfers did not have to impose any cost on anyone who was politically relevant to them. They could simply take the money. In the case of Alaska, they were not called on to do anything that imposed costs on anyone. Selling their petroleum at the highest price was indeed the course of action that benefited the rest of the world more than any alternative.¹⁰

The Arabs organized a cartel, but it seems to have been an accidental by-product of the 1973 war. The strengthening of the cartel in 1979 was also a by-product, in this case of the Iran-Iraq war. In any event, the people injured by the cartel were entirely outside of the Arabs' direct political jurisdiction. Thus, it is quite different from the average cartel. Indeed, it closely resembles such things as the piratical expeditions of Drake.

Transitional Gains from Higher Education

Let us consider then some more normal transfers. The obvious one, of course, is the transfer of money from the average citizen to people who have more than average talent and hence would normally have higher than average incomes, by way of the university system. The first thing to be said here is that it is not really obvious that there is any true transfer here except for inframarginal individuals. Those of us who are inside the margin, either as employees of universities or as students, may be making a gain in the form of a rent, but as usual in economics, it is not very obvious that there are inframarginal individuals or that the gains are very great.

Leaving this possibility aside, employees of the university system are being compensated at their opportunity cost. It may be that many of them have relatively little talent to do anything else so that the mere existence of the university system pushes their total income up, but this once again is not obvious. In any event, I propose to ignore the employees for a while and concentrate on the theoretical beneficiaries, the students.

If we go back to the early days when these universities were first founded, there clearly was a transitional gain. The first state university in the United States was in South Carolina, and there can be no doubt that the students who went there in the first few years made a gain even though the subjects they studied would, we would think today, have had no commercial value. They came out knowing Latin and Greek, but also certified as upper class. At first, there were

¹⁰The federal government's refusal to permit exploration for oil in most of Alaska or the export of the oil is another matter.

relatively few such people in South Carolina. Thus, there was considerable scarcity value in the degree. With time of course, and with more people entering the university until such time as the present discounted income stream of going to the university was the same as going to work, this gain vanished. At this later stage, the university cost the state money but conferred no benefit on students. Government agencies are hard to terminate, however, and those students who were in residence at any given time would have lost from the termination of the university.¹¹ In this case, and I think this is very nearly unique, there would have been a transitional gain, however, from discontinuing the university. If it had been stopped, those people who had already graduated would with time have begun to get positive gains on their degrees because the number of university graduates would decline. The gain would be a distant one, however, since death and retirement is a very slow process.

Every expansion of the university would create a somewhat similar transitional gain for students who had not previously been eligible. Further, changes in the university, such as teaching subjects with more immediate commercial value, would be a distinct advantage to the students who took these courses in the early days. When the modernized university, with its new business and accounting courses had been in existence for some time, once again, students would make their decisions in such a way that the marginal student had an income the same as that of what he would have had had he chosen not to go to school.

As far as I can see, that is indeed what the present statistical studies of return to education show. There have been times in which it seemed to be positive, mainly after large expansions of the university, and then periods in which it seemed to be negative, but I suspect the latter was purely transitional.

I have given very little discussion to the alternative theory of higher education, which is that it is simply a certification process rather than an educational process. That is, the possession of a degree indicates that you have a certain level of intelligence and willingness to work hard, rather than that you have learned certain things. This theory has always been disliked by academics because it implies that we really are not teaching people very much, and that the students who choose easy courses and forget what they have learned right after the exam may well be wiser than we.

¹¹The university was stopped and then restarted after a number of years as a result of post-Civil War developments.

I am going to continue paying relatively little attention to the certification aspect of the school. Clearly, if that is what it does, then it does it in a very inefficient way, and very large resources could be saved by switching to a more efficient way of measuring intelligence and willingness to work. I shall also pay little attention to the possible rents of faculty members.

The outstanding characteristics of this very large activity is that, insofar as it subsidizes anybody, it subsidizes people who would do well in life anyway. It is not obvious, however, that any subsidy is derived. It may be pure waste, and there is certainly a large element of waste. The beneficiaries were mainly people who achieved a transitional gain when the organization was set up and the running costs were quite high.

Note that in all of these cases there is the excess burden that is normally discussed in connection with any tax or monopoly. There is also another excess burden because recipients of the funds also change their behavior. There is then the rent-seeking cost, the cost of arranging all of this by lobbying or whatever methods are used, and in some cases a rent-avoidance cost of people who are trying to avoid paying these rents. Lastly, there is the pure waste through the inefficiency with which the funds are in fact transferred. It is to this last cost that I now wish to turn.

The Rationale for Inefficient Transfers

Consider the current educational system and assume that the money raised from the taxpayer to pay for higher education was simply given as a cash gift to those people who have the capacities to get through whatever the requirements of the university are. They could then use this amount of money to pay tuition in a school that charged its full costs, which might be much lower than those that our present universities charge, or they could invest it in some other way. If you do not trust young people, you might insist that they invest it rather than spend it, although it is by no means obvious that time spent in the university is actually an investment rather than a consumption good.

Clearly, the excess burden to the taxpayer would be the same, but the excess burden on the recipients would be less than with our present arrangement. It is not obvious what would happen to the rent-seeking cost because this large sum of money would probably be worth more to the recipients, so they would be willing to invest more in rent seeking. Producers of things that the potential students would choose not to buy would suffer to some extent, although

presumably not a great deal, and those who are providing things the students would choose to buy would gain. Again, probably not a great deal. Except for one group of factor producers, nobody seems to be injured by the change, but it should be said that the factor producers would be the ones to whom the legislature and the average citizen would normally turn for advice on reorganization of the educational system.

In Alaska somewhat the same situation pertains. Simply paying the money out in cash to the citizens of Alaska, preferably in the form of transferable certificates for future income, would be better from their standpoint and would injure no one except a certain number of factor producers, in this case primarily civil servants or potential civil servants. Again the loss would be small, and the gain to other factor producers would also be small. It is hard to see what the effect on rent-seeking activity would be in this case, because it would be very important that this be done quickly so that a large number of people would not pour into Alaska to share the gift.

Why do we not observe these efficient methods of transfer instead of the inefficient methods? I think the answer is ignorance. If we look at the learned literature, we find the only kinds of transfer that are ever advocated are transfers to the poor, a real but not very large part of our transfer economy. Most people are willing to make at least some gifts to the poor, and doing so is actually a productive activity that makes both the giver and the recipient better off.

Transfers back and forth in the middle class, however, which is what we actually observe, are discussed only by people who argue that they should stop. You can search the literature in great detail without finding anyone who actually is arguing for an efficient method of making them. People who talk about them invariably talk about them as undesirable.

There is an old chestnut which I heard when I was at the University of Chicago before World War II and which still is occasionally repeated by Chicago types. It is that we could make the farmers of the United States much better off than they are now while saving the taxpayer money by simply giving them cash instead of maintaining our present programs. This was not offered as a real suggestion, but as a criticism of our present programs.

Indeed, in this case, the statement about transfers is normally made in a very casual and careless way with the result that Gary Becker (1983) was able to demonstrate that it was not obviously correct. It might be quite difficult to distribute cash to the farmers in exactly the same amounts as they now receive. None of the people who offered this typically Chicagoan criticism ever gave any attention to

it, and hence it is easy for Becker to demonstrate that their specific proposals would not distribute the money in exactly the same way as the present program.¹²

In all of this, the proposal is typical. We find in the literature occasional references to this kind of transfer, which is after all the dominant one in our society, as being inefficient in contrast to a cash transfer. We never find discussion of how *efficient* transfers from badly organized middle-class voters to well-organized groups should be organized.

Under the circumstances, it would not be surprising if the average voter or the average politician were ignorant of how to do it. I do not think that very many economists have given any thought to the matter. The reason that economists have not given any thought to this, and for that matter are not likely to, is first, it is obviously a bad thing to do. Second, politically no one is going to follow their advice because a certain element of concealment and confusion is necessary to get the voters to favor such programs. Open cash transfers, which appear to be the efficient way, are just too blatant and could not get through in a democracy.

Thus, we have a combination of an absence of any technical discussion of this subject in the technical literature, and strong reasons why people in favor of such transfers would not be willing to talk in clear-cut efficiency terms. Thus, that people would behave in a rather inefficient way is not at all surprising.

Another problem is that other groups who might conceivably offer technical advice in these areas—government employees and potential government employees who will eventually administer the programs—are, on the whole, not in favor of efficient transfers. Their salaries depend to a considerable extent on the existence of fairly large and complex structures which may be eliminated in the name of efficiency. The academics who are hired by these people to engage in research on these programs also normally know on which side their bread is buttered.

Further, the people who are professionally engaged in urging this kind of transfer normally are aware that simple efficient transfers would not get through the democratic process. Hence, one of their major talents is in inventing complicated procedures that conceal the nature of the transfer and which almost by definition are apt to be inefficient.

¹²There is no reason to believe that the politicians have selected the optimal redistribution money from the standpoint of political gain.

The result is inefficient transfers—transfers so inefficient that normally only the transitional gain is real. The transitional gain, of course, tends to be devoured by rent-seeking costs. The result is what I call the “Chinese type economy” and what my old friend Alex Kafka referred to as “South Americanization,” in which government is engaged in a very large number of activities that are normally a sort of distant result of rent seeking sometime in the past. There is usually strong opposition by various well-organized special interests to terminating the program.

More efficient transfers could, of course, if we only go this far, lead to a higher national income. Unfortunately, these more efficient transfers would inevitably lead to more rent seeking. If there is more money to be obtained, more resources will be put into seeking it.

Conclusion

The general picture that emerges is not a very pleasant one. No one looking at real world governments can doubt that they do to some extent generate genuine public goods. No one observing them can doubt they also engage in a lot of transfers, mostly the result of rent seeking. Indeed, Dwight Lee (1986) has argued that what public goods they do generate are normally a by-product of rent seeking by the factor suppliers in those areas.

In the 19th century, England deliberately and consciously moved away from a very well-developed, rent-seeking society to one of the most open economies known to history. I can think of few more important research topics than a careful examination of how they did it. By this I do not mean what bills they passed, but how the political support was developed for those bills. Lacking the magic formula which might conceivably come out of that research, all we can do today is to argue against rent-seeking activity. Whether our arguments will have any impact is an open question.

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