This Week's Growth Fallacy: Welfare

Proposing solutions to West Virginia's economic troubles is as commonplace as the sunrise. Sadly, most of them ignore simple economic reasoning and, if instituted, would hurt, not help, our foundering economy. For example, many feel that increasing public investment in education is a way to bolster our economy; however, the idea is blind of the fact that public education is riddled with incentive problems and, should a quality higher education be provided, businesses that can take advantage of this increased human capital still refuse to operate within our borders. Or, some feel that increasing federal spending within the state will jump start the economy; as I wrote last week, this, too, will only drag down our economy and keep us poor relative to our neighbors.

This week, however, I'd like to focus on another supposed panacea for the West Virginia economy—welfare. Many supporters of increasing the scope of the welfare system believe that doing so assists the poor at minimal cost to society—and what cost is borne upon society is located entirely upon the financially well-to-do.

What welfare proponents assume is that an economy is a fixed pie of wealth that is divided amongst the members of society. If Bill Gates did not have $40 billion in net worth, then this money would be reallocated somehow amongst the rest of the world. This mindset neglects the simple fact that trade creates value; Bill Gates did not transfer $40 billion away from others to himself by making computer products. Instead, he created $40 billion in wealth that did not exist prior to Microsoft, nor would have otherwise existed without him.

What must be considered, then, are the incentives that the Bill Gates' of the world confront when faced with an overbearing welfare system. Should an ever larger portion of Bill Gates' wealth be reallocated to others, his incentive to earn additional money is reduced. Think of the extreme case of everyone's wealth being evenly redistributed throughout an economy; you earn for yourself what you like, put it into society's pot, and everyone receives an equal share. No one has an incentive to earn any additional wealth for themselves by providing goods and services of value through the market system; after all, each additional dollar in profits must be split about 2 million ways if such a system existed in West Virginia. In order to retain the crucial incentive to be productive, what we need is not a system of reallocation but of protection, of ensuring that money people earn is money that people keep.

When studying public economics, one quickly learns that there always exists a tradeoff between efficiency and equality. Efficiency refers to the ability of an unfettered market system to allocate good and services according to who values them the most; equality refers to minimizing the disparity in economic outcomes achieved in an economic system. Economies pursuing solely "efficient" or "equitable" outcomes are likely to be distasteful for most. Many in society would agree that some level of social support should be publicly provided for the less fortunate; any amount of government assistance provided in this manner pushes the economy away from the "efficient" outcome. Similarly, an economy concerned only with perfectly equitable outcomes will fester in the low productivity that results from not being rewarded for adding goods and services of value to society. (Communist economies show not only the long run viability of striving toward equitable outcomes for all, but also the ability to achieve that goal on even a minor scale.) So long as individuals in society generate different ends for themselves, the economy is not perfectly "equitable."

Welfare systems exist to push economies towards more equitable outcomes, but as the tradeoff above describes, these systems come at the expense of efficiency. In other words, it is at the expense of potential growth by which welfare systems exist. Again, most in society are willing to trade some growth for a certain minimum standard of living for all. But to ascribe the economic well-being of a society to the existence of a welfare system is to put the horse before the carriage. A welfare system by its very nature does not generate wealth; if anything, it is something that an already wealthy society can burden itself with in order to achieve certain social ends, such as health care, unemployment insurance and food stamps. To argue, as some here in West Virginia have, that a strong and ever-expanding welfare system is the path to a thriving economy is to make the mistake of confusing correlation with causation; similarly, to cite a famous example, one certainly wouldn't attribute the existence of sunspots to improved stock market performance even though they have been shown to exist simultaneously. Do not believe such nonsense.

A widening of the current welfare system in our state will not improve our sluggish economy; in fact, it will further reduce the incentive for businesses to provide goods and services within West Virginia and keep us at the bottom of the country.

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