THE 'PUBLIC GOOD' RATIONALE FOR THE WELFARE STATE: A CRITIQUE

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One of the arguments most frequently used against the free operation of market forces is that people will avoid paying for goods which they consume - they will take a free ride - so that the total provision of that good will be less than is desirable. In the terminology of economics there are (1) Public goods, goods which can be consumed by all without exclusion, and which are not diminished by use (examples commonly given: national defence, clearn air) (2) Externalities, social costs and benefits yielded by private activities, which are not taken into account in the private transaction. An example of a social cost might be a biscuit factory billowing out smoke, and a social benefit might be orchestral music wafting out onto the street from a concert hall. Such cases are employed as an argument for government intervention in the form of regulation, subsidies or taxes. Liberals have usually responded with the argument that, where there are problems, these are not so much due to market failure as to an absence of private property rights.[1] In economics textbooks a popular example of a public good used to be the transmission of television programmes: television stations like the BBC beam out across the whole country, so that no-one can be prevented from tuning in, and any one person doing so does not reduce the amount of viewing available for subsequent viewers. This form of broadcasting was adopted, not because of anything intrinsic to television broadcasting, but because, with funding from licence fees (or, in the case of ITV, from advertising), there was no need for exclusion. In a market environment TV broadcasting has developed methods of exclusion, as with cable transmission. The point here is that public goods are only public goods because they are provided as public goods; public goods/externalities only persist in the absence of markets. All public goods, following the introduction of property rights, can become private goods. If rivers were privately owned then the owners of chemical factories would bargain with river-owners to reach an agreeable compromise, with an agreed amount of river pollution. Similarly, with enforceable property rights, lake-owners in Sweden could sue English industrialists for contributing to acid rain pollution.

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All this is by way of introduction. A great amount of ink has already been spilled on this subject, and my aim here is not to go over the debates. Rather, I wish to address a particular application of the argument to the welfare state.

UTILITY INTERDEPENDENCE

Utility interdependence is the term used in the literature of health economics to describe the caring externality. Each person has an ordering of preferences. The caring externality - utility interdependence - arises when the well-being of other people enters into my preference schedule. For example, in my preference schedule, I may obtain a higher level of utility by giving money to the destitute, than from putting the same money into space invaders machines. This means that, if I am currently spending the money on space invaders, then I will raise my utility by instead giving the money to the destitute.

Complications arise if acts of charity are a public good. Many more people than I will care about the fate of the destitute, but their knowledge of my charitable intentions may lead them to keep what they otherwise would have given, to free-ride on my benevolence. If we all thought the same way then nothing would be done for the destitute. In the words of Milton Friedman:

> It can be argued that private charity is insufficient because the benefits from it accrue to people other than those who make the gifts ... I am distressed by the sight of poverty; I am benefitted by its alleviation; but I am benefitted equally whether I or someone else pays for its alleviation.[2]

In terms of utility interdependence this means that my utility is lower than it could be. I would have preferred to have given to the destitute, but because I knew that others would refrain from giving if I did, then I decided to use the money for another purpose.

Furthermore, there are many free-riders on charity. There are those who will benefit from observing the alleviation of poverty, but prefer not to pay for it. The defect of any private initiative is that, although these people have a positive preference for charity, if approached they will deny it.

The result of all this is that the amount of charitable giving is sub-optimal. It is a level of giving which is less than satisfactory for the donors. And here is the case for government redistribution. For, if charitable contributions were compulsory then, not only would the position of the destitute would be improved, but also, donors would be brought to a higher level of utility.

THE SOCIAL CONTRACT WELFARE STATE

This approach, the theory of utility interdependence, is advanced as a positive theory of the welfare state: an explanation of why the welfare state arose. The argument is given like this by A. J. Culyer:

> The very *existence* of the Welfare State is evidence *for* the proposition that specific caring exists, for if individuals did not care for one another then no externality would exist and there would be little reason for collectivist action.[3]

This argument conceives of the welfare state as a kind of social contract. Without compulsion, as explained above, individuals who ‘‘care’’ are left at a lower level of utility than is possible. The social contract welfare state then provides a solution because everyone agrees to be compelled to contribute because *everyone* is so compelled. All agree to this welfare state because it eliminates the problems of caring externalities.

The possibility of such a social contract actually happening is remote. This is the more so bearing in mind the externality problem which the contract is supposed to solve. For, in the same way that each individual aims to freeride upon the donations of others, there is also an incentive to deny any wish for a welfare state. If, as is argued, the benefits of a social contract accrue to all, then all the potential beneficiaries will sit back in the expectation that someone else will formulate, and agitate for, such a proposal to be voted on. Under the terms of its own argument, the social contract theory of the welfare state fails as a plausible explanation.

More realistically, the welfare state may be viewed as originating from preferences expressed through parliamentary elections. This view, it should be made clear, is wholly different from a social contract explanation. The social contract is agreed to by every person and comes under its auspices, whereas simple voting admits the possibility of majority coercion of minorities. It is also no longer part of the explanation that the welfare state outcome arose to solve externality problems; it becomes just another government policy, presented and voted on. It loses that special rationale.

Once the conceptual jump is made from the theory to government involvement, then it has been assumed that individual preferences can be known to an outside observer. The claim is that, through central direction, governors can enhance the utility of individuals. Now consider the position of someone who genuinely cares nothing for the plight of the destitute (or perhaps would prefer that his money went to sick animals, or be given to fund soup kitchens rather than provided in cash, etc.). Such people do not exist in the social contract theory of the welfare state. Anyone who denies their support for welfare is assumed to be a free-rider, who ‘really’ values the alleviation of poverty, but denies this in the hope of avoiding the need to make a contribution. The theory proposes a ‘heads-you-win’ question: it assumes that, whatever the stated preference, the respondent does want forced retribution. This explanation of the welfare state, so contrived, is immune to refutation.

AS A JUSTIFICATION

The same theory is used, not only as a positive theory to explain the existence of the welfare state, but also as a justification for why there *should* be a welfare state.

Taken at the ethical level, the theory is most objectionable. For the conclusion is that fiscal redistribution for the welfare state involves no coercion, and no possibility of coercion. It provides forced redistribution with a cloak of volition.

If the theory is to be applied to policy then the first difficulty which arises is the identification of free-rider cases. The data of the theory - preferences - reside solely in the individuals, and are not accessible to any outside assessor. This makes any practical distinction between outcomes which are the result of satisfied preferences, and outcomes which result from frustrated preferences, an impossibility.

As an aside, the free-rider theory itself should by no means be taken at face value. The claim of the theory is that people will consistently choose to contribute an amount to private charity which is less than they would prefer. While it is plausible that in a one-off instance the action of freeriders can limit giving to an unsatisfactory level, in the longer term it seems far more likely that people would amend their behaviour, and improve their own utility, by giving more. This is not to say that in the long run some will not receive unpaid-for benefits from the charitable contributions of others. What it does mean is that the total amount of charity provided cannot be less than the unsatisfactory amount, to those who value giving it.

All human activity creates external costs and benefits. Government intervention in the economy is no exception. Hence, government action which aims to correct ‘‘market failure’’ will in itself create other external costs and benefits. One consequence of the welfare state neglected by proponents of the social contract is that the total amount of voluntary charitable giving will be reduced. By the terms of the same free-rider argument, some who would have contributed to charitable works can instead benefit from observing the relief provided through the involuntary welfare state.

The most fundamental ethical objection concerns the presumption made in the social contract theory that preference externalities can give a justification for state action. In the theory ‘caring’ feelings are taken as the standard of ethics. In liberal thought, individual choice is paramount, regardless of any bearing this has upon the preferences of observers. My personal choice, for example, might be to wear floral shirts, which are highly offensive to the sensibilities of any onlookers. This is a case of external cost, but rectification would entail a violation of my free choice. Externality cannot be the standard of ethics because, in a free society, there will always be individual choices which others hold to be distasteful.

NOTES

1. See for example, Steven Cheung, *The Myth of Social Cost*, Institute of Economic Affairs, London, 1978.
2. Milton Friedman, *Capitalism and Freedom*, University of Chicago Press, 1962, p. 190.
3. A. J. Culyer, *The Political Economy of Social Policy*, Martin Robertson, Oxford, 1980, p. 65.