

Chapter 7

Political and Economic Freedom in the Welfare State: Some Basic Concepts Applied to the Case of Sweden

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Introduction

When I first was asked to present this paper I was quite ignorant of how little of good theory economists really have when it comes to a basic analysis of an almost socio-philosophical character of freedom, rights, liberty, rules, et cetera in society. Few of the words mentioned here will be found in the indices of standard textbooks in economics. We all, however, use the words frequently in our daily argumentation. But what scientific background have we got for our everyday conversation?

Ambiguity or perhaps deliberate obscurity rules in this area. The Swedish prime minister recently claimed that economic *and* political freedom were increased when government expenditures and taxes were increased for social welfare purposes. More decisions were then to be made in “democratic order” (i.e., by a majority decision rule), and economic freedom was increased in the case of sickness, old age, unemployment, et cetera. The price paid was a smaller post-tax choice set, that on the average is compensated for by a larger post-subsidy choice set. Economic freedom might, following the argument, be decreased for some but increased for a majority. The potential or actual coercion that follows from a majority decision is often neglected.

But how should economists as social scientists argue in a discussion about political and economic freedom? We have no simple measure stating that economic freedom has increased by x percent or that political and

civil freedom has decreased by y percent in the same way as we talk about changes in the GNP. We have not even got a common ordinal scale for metering freedom or liberty. Most of the economists' measures are taken from the market, where quantification is simple: Prices and exchanged commodities are easily metered. Although many economists (including myself) believe that economics has something to do with relations (mainly exchanges) between individuals in a system of social order, almost all our measurements refer to flows and stocks of commodities. Only on rare occasions do we deal *directly* with relations between individuals.

A starting point for a discussion about freedom must, however, be an analysis of *relations* between individuals or groups of individuals. It is rather meaningless to ask if Robinson Crusoe was free or not, at least not until Friday when his relatives appear on the island. Freedom of speech does not seem to be an important human right until there is at least one listener. Although many of us support the idea that an "exchange" paradigm is more important for the development of economic science than a traditional "optimization cum equilibrium" paradigm, we have little to offer when it comes to hard analysis of social and economic relationships. Recent contract and property rights theory is far behind the logical and mathematical refinements that characterize present-day general equilibrium theory. It is also interesting to compare on one side the large space devoted to show the correspondence between preference logic and utility functions as a description of individual choices with, on the other side, the almost complete neglect of analysis of more complicated but equally important concepts like (private) property rights which can be found in the theoretical standard works (e.g., Debreu 1959, or Arrow-Hahn 1971).

Property rights can be taken as an example of the type of analysis that will be used in this paper. In the standard textbook it seems as if "ownership" is a relation between an individual and a physical object: Smith owns a piece of land. In a more sophisticated analysis ownership is regarded as a relationship between individuals (for examples, see many of the articles in Furubotn-Pejovich). Ownership then means that Smith can exclude other persons—but perhaps not all persons—from entering or using the land. We will in the following say that Smith has a right or a *claim* that another person should not use the land. For a full definition of a claim we need a certain action, say, entering the land or picking rare orchids on the land. According to Swedish common law, the right-of-way principle will in general mean that an "owner" does not have a claim that other persons should not walk on his property. In general we have to define a claim as existing or not existing for a pair of individuals (P_i ; P_j) with regard to a certain action (A_k).

For a full description of the “claim” aspect of property rights or ownership we need a full matrix describing if a certain person has a claim or not for a certain action against other persons. A claim might be valid against some persons but not against other persons; e.g., members of the police force or officials.

But we can also talk about Smith’s *freedom* (liberty, privilege) to enter his own land. But when it comes to picking rare flowers Smith might be denied this possibility, say, by nature preservation legislation. A third aspect is if Smith can transfer his “ownership” or title to the land to other persons. This aspect could be called legal *power* or competence. If Smith is a Swedish citizen with land in Sweden he will in general be denied the right to sell his property to non-Swedish citizens. For some types of land there will be more restrictions regarding potential buyers; agricultural land and forests can only be transferred to relatives or to persons accepted by land authorities.

A fourth aspect is if Smith’s ownership (or perhaps only some aspects of his ownership) can be changed or altered by another person (or by authorities). This will be called the *immunity* aspect of ownership. New legislation might thus change some of the actions that Smith is allowed to perform on land under his title. According to Swedish law, the government can change or prohibit actions on the land without compensation (say, changing town planning restrictions regarding number of storeys or density of new buildings on the land). The land owner thus lacks immunity with regard to certain actions performed by the government. (As will be obvious later, immunity is in general an aspect which is of importance in the relationships between individuals and the government.) However, according to the basic “rights” in the Swedish constitution, a final transfer of title can only take place with compensation from the government. But property rights can be diluted to the point where economic compensation for government expropriation becomes a token.

We have heard four words—claim, freedom, power and immunity—used to characterize different aspects of property rights. These are also the four words used by Hohfeld in his pathbreaking essay on what he thought to be “the lowest common denominators of the law” (Hohfeld, 1913). In this paper Hohfeld’s concepts will be used with some minor changes proposed by some Swedish scientists emanating from jurisprudence and philosophy. The main reason for using this conceptual framework is completely eclectic. In the property rights literature or in the economic analysis of contracts, rights, rules, et cetera, I have seen no coherent conceptual framework. Even Hohfeld’s analysis seems to be neglected or unknown. Neither Rawls nor Nozick and Buchanan, as leading representatives of a school of “neo-contractarians,” are using this type

of analysis (however, Nozick mentions Hohfeld *en passant* in a footnote). None of the three has elaborated his own theory of rights, and they are all using “rights” in rather ambiguous ways and making no distinction between, for example, the freedom (liberty) aspect and the immunity aspect.

In the next section Hohfeld’s concepts will be presented in a more complete way with some of the additions proposed by recent research in jurisprudence. The section that then follows contains a short discussion of some of the basic types of contracts that are of importance for an analysis of “economic and political freedom.” To a certain point it is possible to make a connection between the basic type of contracts and Hohfeld’s concepts. Finally, follows a part of the paper where the concepts developed are applied in a discussion of some features in a highly mature “welfare state” like Sweden.

Basic Concepts of “Rights”

A simple conclusion from the previous discussion of property rights is that ownership is not a simple atomic concept but can be seen as a bundle of different characteristics. To say that a person has a “right” generally means that he has a complex aggregate of claims, liberties, powers and immunities with regard to other persons or groups of persons. In the elaboration of a classification scheme of “rights,” the following points are important:

1. “Rights” should be regarded as relations between two parties.
2. Different “rights” can be regarded as bundles or aggregates of more basic concepts.
3. There are logical relations between the basic concepts.

The first point has been illustrated by the example of property right: One important aspect is the legal possibility of excluding other persons from using the object of ownership. In a more general setting, rights, liberties and freedom can be regarded as relationships. Often rights are not formulated in this way, but a simple example from the UN declaration of rights can illustrate how a reformulation can be made.

Article 9 reads: “No one shall be subjected to arbitrary arrest, detention or exile.” A possible reformulation could then be (for the “arrest” part of the sentence):

For all individuals x and all states y such that x finds himself in the country y and is not suspected of having committed a crime

x has versus y	(parties involved)
a “right”	(legal relation)
that x is not arrested by y	(action concerned or state of affair; Kanger, 1984)

As this example shows, declarations of rights to a large degree consist of relationships between individuals (or individual citizens) and the state, and of rights in which the immunity aspect is important. But modern declarations of rights are also strongly influenced by the ideology of the welfare states as, for example, in Article 26:1 in the UN declaration of rights:

Everyone has the right to education. Education shall be free, at least in the elementary...stages. Elementary education shall be compulsory...

This Article will then mean:

For all individuals x and all states y such that x is an inhabitant of y
x has versus y
a “right” that x is given free elementary education
y has versus x
a “right” that x participates in education.

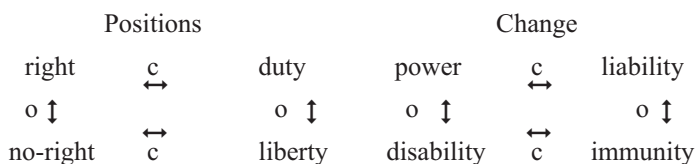
The first type of right is obviously of the claim type. The second is a negation of x’s liberty to abstain from the education. A possible interpretation is a claim from the state versus x. From this Article will also follow that y has tax claim on other citizens or on x at another stage of life.

An important part of Hohfeld’s analysis is that the different types of “rights” stand in definite logical relationships to each other. If a landowner has a claim that a person should not enter his land, this also means that the other person has a duty (or obligation) not to enter the land. As soon as there is a claim from x versus y there will be a “correlative” duty from y versus x. In the language of deontic logic a claim from x means that y *shall do* or shall perform a certain act.

As shown later, Hohfeld’s concept of liberty (freedom or privilege) is logically not clear. It might mean either that x may act in a certain way or that x may refrain from acting (Kanger, 1966; Lindahl, 1977). We will however not go into further detail in this intricate issue; for our purposes it is sufficient to note that liberty stresses that certain acts *may* be performed. It is an absence of duty and can thus be regarded as the opposite of a duty. The correlative—usually called “no-right”—has been shown to create some minor problems with the internal logic and shall not be explained here.

In the same way there will be correlative and opposite pairs with regard to power and immunity. The correlative of power is liability, and the correlative of immunity is disability. If x has an immunity versus the state with regard to changes of the legal character of some parts of what constitutes ownership, the state has a corresponding or correlative disability. But disability is also the opposite of power as liability is the opposite of immunity.

If right - duty - liberty - no-right can be used for describing legal positions the other quartet is mainly aimed at describing legal changes. The figure below shows how the four concepts in each group are connected:



o = opposite concepts; c = correlated concepts

The concepts proposed by Hohfeld as a kind of legal “quarks” have been analysed and refined with the use of deontic logic, i.e., the logic of sentences based on “shall do” and “may do” (see Lindahl 1977; Talja 1980). But for our more modest purposes it is sufficient to bring in some of the basic distinctions originally made by Hohfeld, who used more of intuition and a judicial hunch than of formal logic. His arguments are also in a legal research tradition as they are based on analysis of a large number of cases.

Basic Types of Contracts

In the previous section the aim was to find some concepts of legal rights that can be building-stones for different types of contracts. In this section some basic types of contracts will be characterized. Hopefully most of the contracts of economic importance will belong to one or another of the types here mentioned.

The first type of contract is a general type of ownership or *exclusion rights*: x can exclude y. As has already been discussed, property rights are really a bundle or an aggregate of more basic rights.

Another type of contract or relationship is *voluntary exchange*, a quid pro quo type of relationship. Most of economic theory is about this type of relationship between a seller and a buyer, but in most cases the relationship is never made explicit as most transactions are thought of as taking place in an anonymous market. (When we talk about markets do we not

really mean firms specializing in transaction? Should not “between firms” or “within firms” be substituted for “markets” or “hierarchies”?)

A third type of relationship is between *principal and agent*. This type of relation was described by Hohfeld as “the grant of legal powers to the so-called agent, and the creation of correlative liabilities in the principal.” In the economic context the study of principal-agent relations has mainly concentrated on the potential conflict of interests.

As our fourth type of relation or contract we will take a *patron-client* relation. In an extreme case this will be a master-slave relationship. The basic idea is that the client has given up some rights which have been taken over by the patron. An employment contract has more features of a patron-client relation than an ordinary exchange contract, although duties and corresponding claims are specified in both cases.

A fifth and more complicated relation is the formation of an *association*; individuals x, y and z form together a new subject s. The basic contract (or the constitution when it comes to the state) has, among many other things, to specify a decision rule with which the interests of the participants are transformed into actions by the association.

In a modern society every individual will have contractual relations with many other individuals. They are members of the state, of the county and the local community, to mention some important political and compulsory associations. They belong to different trade unions or other interest groups with voluntary membership.

But a membership in an association usually also means establishment of principal-agent and patron-client relations. The voter is a principal, his representative member of parliament (or the local community council) his agent. But the MP is, in his turn, a principal in relation to the public administration. In the next step the administration may play a patron role against the original voter, who now is a client; the unemployed votes for an MP who controls the budget and the rules of the unemployment insurance system (working on behalf of the political part of the government) which in its turn unilaterally but according to rules or statutes can determine how much unemployment benefits shall be paid out to the original but unemployed voter.

The emergence of these types of rather complex chains of relations may be a typical feature of a welfare state in which government programmes have taken over the role of private insurance; a simple exchange relationship between a provider of insurance or health care and a customer on a voluntary basis has been transformed into a chain of relations of a partly very complex nature and involving explicit or implicit coercion. We have

just mentioned one side of the coin; the other is a similar complex chain for determining the taxes that have to be paid for the services provided.

We will not go into detail here in a description of the different relations society's members are involved in. It may be sufficient to observe that a very dense network of contractual relations will probably create a stability for society.

An Application: The Swedish Case

Sweden is an extreme case of the modern welfare state. At present the size of the public sector (consumption, investments and transfers) is roughly equal to 65 percent of GDP, compared with less than 40 percent for the United States. Although the growth rate has slowed down considerably since 1970, Sweden still has a per capita GDP placing her at one of the top positions in the wealth league. To many economists a large public sector would mean a decrease in economic "freedom." It is not equally obvious that a large government sector will mean a corresponding increase in political "freedom." Only if one is a supporter of an extreme majority rule doctrine would this be true. The extreme case would be that all social states had to be ranked by a majority principle and that there were no areas of complete privateness.

The size of the public sector is an indication that government compared with a classical constitutional market economy is involved in many areas where most of the services provided are of strictly private character. Although all formal rules of the democratic game are followed, an extreme case of the Swedish type means that coercion might be large. The question an economist would ask would be: How much of the public sector would be left if we adopted a rule of (almost) unanimity of the Wicksellian type? A partial answer to this question might be given by the Finnish neighbour using a rule of qualified majority for taxes and expenditures and with a public sector share of GDP of a little more than 40 percent.

Instead of discussing in terms of political, economic and civil freedom, we will try to apply some of the concepts developed earlier to indicate some specific features in the contractual structures of the welfare state.

The most important association is, of course, the state. The basic social contract will then be the constitution. The present Swedish constitution was changed in 1970 in the direction of what could be called a super-democratic constitution with few obstacles for quick decision making in the political field. One-chamber system with elections every third year creates a momentum in the political sphere. The powers given to government are virtually unrestricted. Except for some almost classical civil rights of the

immunity type (freedom of speech and organisation, etc.), there are only two immunities in the economic field (expropriation of real estate can only be made after compensation and a clause against retroactive taxation, that has been morally violated twice). In principle, government could increase taxes to 100 percent.

As has been discussed earlier, the extension of government into fields that could be managed by private markets drastically changes the complete contract structure. In the private market we have a duty to pay for services and a claim to get them but also a liberty to change between different producers. In the welfare state this liberty (or power) has disappeared, and there is no direct correspondence between the individual claims of services and the state's claim of tax payments in the individual case.

State ownership in the usual sense of the word is rather insignificant in the manufacturing sector. One could perhaps even think about a tacit agreement, a kind of supra-contract between the political sector and the industry, similar to the concordats between state and church in many countries. The content of this concordat would then be that government accepts and morally supports a viable and internationally competitive industrial sector with virtually free entry and no or rather low protection or direct financial support (except for some years after 1976 with some disastrous results). Restrictions on private property rights or direct government ownership are mainly limited to domestic sectors and especially the tax-financed service sectors.

The Swedish economy is an open economy with few regulations. There are still some regulations regarding free capital movements. In the rights context this means that the power and liberty aspects are strong in this sector of the economy but they are weak in other parts of the economy. There are few restrictions against free entry in the industrial sector, while at the same time restrictions limiting individual liberty and power apply to the domestic sectors. I am free to start a factory and sell industrial commodities to everybody inside or outside the country, but I am not allowed to start a school without government approval. Even if freedom of speech and expression is guaranteed (an immunity type of right), I have no right to start a radio or TV station (lack of power or liberty). I have a claim versus the government that it should provide me with health care, schools for my children and long-term care for my parents. But I have little choice in selecting the provider, and it might even be difficult to start a fee-paying private alternative.

Are there any simple explanations of this duality in the economic structure: a highly capitalistic export-oriented sector and domestic sectors like health, housing, education and culture dominated by a doctrine of social welfarism? One possible answer might be that different international

agreements put restrictions on what governments can do. By such agreements a government can commit itself to a free trade policy and thus create an immunity against pressure groups on the domestic scene. There are few or no similar commitment alternatives for non-traded commodities. The immunity against political interventions in the export sectors are thus not guaranteed by the domestic legal framework but through mutual international agreements.

But remember how difficult things can be if we use ambiguous concepts. In everyday language a government signing an international agreement on free trade gives up some “economic freedom,” i.e., the liberties and powers to do unwise things on the domestic scene. At the same time the export industries gain some “economic freedom,” i.e., they acquire a certain amount of immunity against involvement of domestic politicians.

New developments in institutional economics, mainly in the public choice field and in the law and economics field (property rights analysis and contract theory), have increased our understanding of how economies work far beyond the incomplete understanding we get from the institutionless neo-classical analysis. But it may be a very hard way before us. The attempt in this paper to bring in some basic concepts from the theory of jurisprudence should be seen as research in progress. It is a test that easily can fail, and it seems at present difficult to navigate an easy route between the oversimplification of the traditional usage of rights and freedom terminology and the still complicated introduction of new but more defined concepts of different types of rights.

A Short Bibliographical Note

In this paper a number of articles and books from jurisprudence and philosophy have been referred to. As this field is not so well known, some short comments might be necessary.

The basic articles by Wesley Newcomb Hohfeld (first at Stanford University, then at Yale University) are:

Some Fundamental Legal Conceptions as Applied in Judicial Reasoning, *Yale Law Journal*, Vol. 23 (1913) and Vol. 26 (1917). Together with an introduction by Walter Wheeler Cook in *Yale Law Review*, Vol. 28 (1919) the articles have been reprinted many times in a volume of Hohfeld's collected works. A recent version was printed in 1964 by Yale University Press.

The Swedish development of Hohfeld's system using the deontic logic originally developed by George Wright has been presented in the following article and monographs:

Kanger, S. and Kanger, H. (1966) Rights and parliamentarism, *Theoria*, Vol. 32, pp. 85-115.

Lindahl, L. (1977) *Position and Change: A Study in Law and Logic*, Synthese Library, Vol. 112.

Kanger, H. (1984) *Human Rights in the UN Declaration*, Uppsala.

Discussion

Edited by Michael A. Walker

Assar Lindbeck It is a fact, I guess, that it is always easier to express yourself with your own classification system and your own terminology. Therefore, when I read this paper, I was not fully convinced that I should shift to this terminology rather than the terminology I am familiar with from previous years.

What I find particularly interesting in Ingemar's paper is the principal-agent system, wherein a rather simple contract between two parties—for instance, between an individual and an insurance company—is replaced by a complicated chain of principal-agent relationships.

Also, I think his discussion of the Swedish economy as a two-sector economy is close to the point, although I would like to modify it a little. It is not really the export sector versus the rest of the economy. The government is really monopolizing or intervening in specific types of services—which I'll come to later—while other services are in the private sector without very much government intervention.

I would like to make a different classification here, and fill it with forms immediately. When I think about individual freedom of choice in the welfare state, I tend to think of three aspects: first, freedom of choice; second, predictability of the effects of choice; and third, civil liberties.

In certain respects, welfare state policies have *increased* individual freedom of choice. Take the example of government guarantees of loans for students. (As a matter of fact, that's a reform Ingemar Stahl was advisor to 20 years ago.) I think that increases the freedom of choice of many individuals because it creates a market that did not exist otherwise because it is very difficult to borrow with human capital as collateral. If governments give guarantees on those types of loans, poor people are given an option to study, which they did not have before.

Some people, moreover, argue that social security systems have been created to compensate for market imperfections, in the sense that moral hazard or adverse selection prevents private markets for insurance from arising to some extent. If that argument is correct, you have another example of a reform that in some sense increases the options of the individual because it creates a market that did not exist before. Of course, by the compulsory nature of the system, as Ingemar points out, that is certainly a

reduction in the freedom of choice for those who could get private insurance anyway.

It is easy to think of welfare state policies that reduce freedom of choice. Let me just briefly mention three types. The first one is distortions of freedom of choice by taxes and subsidies. Suppose that you have a 100 percent marginal income tax rate; it would be impossible for the individual to change his own money income by his own effort. I think everybody would agree that that would be a very severe restriction of his freedom of choice between leisure and income. But that also means that if the marginal tax is 90 percent or 60 percent or even 50 percent, there is a limitation of freedom of choice. In that sense, the conventional economic concept of distortion is really very closely related to reduction of freedom of choice. You could also say it is related to the property rights idea. An individual has certain human capital he can use for leisure or income. The marginal tax rates expropriate part of the return on this human capital, so his freedom of choice is reduced.

The average tax rate is also important here. Suppose you have a very high *average* tax rate and the individual gets non-marketable service in kind in compensation—like health care, education, child care and old age care. That means many individuals will simply be forced to supply much more labour in the market than otherwise to get what they regard as a decent level of consumption. This is very relevant for the Swedish case, because if you pay tax rates that on the margin are about 70 percent in Sweden, as it is for the average citizen with all taxes included, you get lots of services in kind. As a matter of fact, for most families with two children it is impossible for one parent to stay at home; both really have to work in the labour market. So the freedom of choice between looking after your own kids or sending them to a day care centre is eliminated. If a university professor or a colonel has two children, he comes below the poverty limit in the system in Sweden. If he applies for social welfare, then the answer is that his wife should work. So there you have a very clear case where freedom of choice has been reduced, not by the marginal tax but by the high *average* rate combined with transfers in kind. That was the distortion part.

The next part is very obvious, and that is public monopolies. It is not really necessary in a welfare state to create public monopolies because you could have different types of voucher systems as suggested by Milton and others. But, in fact, welfare states tend to create monopolies for day care, old-age care and education. The reason is not clear. It could be that politicians want to control not the income distribution in general but the distribution of specific goods and the quality of those goods. Maybe some politicians enjoy power in general. This is another example where welfare

state policy logically would not require public monopolies but, in fact, in many countries they tend to occur.

Public control in radio and television is another example. As Ingemar pointed out in the paper, it is really amazing that private ownership of newspapers is regarded as completely necessary for a pluralistic, open society like Sweden, but the same persons are completely against breaking up the public monopoly of radio and television. If Gutenberg's innovation were made today, it would certainly be argued that printing presses are too important to be in private hands in the same way as television in our country. So the second part is public monopolies.

The two previously mentioned limitations on individual choice imply that either markets are distorted or you have monopolies. However, the individual is allowed to say whether or not he wants the service at the distorted prices. The third type of limitation of freedom of choice is related to price regulations that create excess demands and queues. It is obvious that rent control has that effect. People cannot get what they want. There is a limitation of freedom of choice in the sense that they would like to have one consumption factor but they cannot get it, and they are rationed by the authorities or through informal rationing.

You have the same thing in the public sector. Public monopolies usually do not charge market clearing prices but set low prices and then ration the goods instead. There you get what I would call a "frustration effect"—not being able to consume what you would at existing relative prices. There might be something deeper here, too, namely that people might value the act of choosing as such. Suppose you have price control and everybody in that system gets exactly the consumption bundle they would choose in the equilibrium market. Still, you could argue that people will be very frustrated and feel that their freedom of choice has been abolished simply because the act of choosing has been eliminated from the system.

The second aspect I want to talk about is predictability of the consequence of choice. Because taxes and subsidies and interventions create problems, governments have to change the rules all the time. They can never predict how people will react, so you get a chain of changes and new rules to compensate for the effect of the previous policy interventions—all the time, in an infinite chain. That means rule instability, and it is very difficult to know what the effect of what you are doing will be. I don't know how to classify this in terms of liberty or choice. It means that you are formally free to choose, but you have no idea what the consequence of your choice will be because the rule might change the next morning.

Another consequence is that when politicians see that the individual is ahead of the state in innovating adjustments, there is a strong temptation to

make the rules so vague that the administration or the courts can make any interpretation they like. You have very strong tendencies in that direction. In Sweden we call them “general clauses.” If you act against the intentions of government, the government can make your decision non-operative. That is also a development that reduces predictability.

My final point is regarding the vagueness of rules. If you have very vague rules, the administration and the courts will have a great deal of discretion. So you move from a system ruled by law to one ruled more by discretion. The public authorities in each individual case decide what shall be done. This very personal power which bureaucrats have over individuals is a problem with regard to civil liberties. This tends to expand because of the necessity to introduce more controls over individual behaviour because of the incentives for tax evasion, benefit fraud, et cetera.

I don't think welfare states have gone very far in intervening against civil liberties, but there is a slight drift in that direction. For instance, a number of years ago the authorities asked individuals to fill in a form where one question, directed toward unmarried or divorced women with children, was: “How many nights a month does your previous husband or your boyfriend spend in your house?” Of course, the mass media were outraged over it. As long as you have a free press that protects civil liberties, I think those types of intrusions on civil liberties will be rather vigorously fought in societies with pluralistic political systems.

Instead of intrusion in civil liberties, I think it is more likely that societies of Sweden's type will get a lot of slack in administration of these benefits—people can get benefits even if they are not entitled to them. It is a trade-off between slack rules and control. Depending on the type of political system, you will get more or less of one thing.

Control has gone furthest in Sweden in the tax system. For instance, small, one-man enterprises in particular have a problem because if they do business with other small enterprises they can be forced to pay the taxes for the others too. The law requires them to check that the others are paying all their taxes on transactions—sales taxes, payroll taxes, et cetera. But we can get insurance against that now; the private sector now has an insurance system for this type of “new risk” that the government has created in the system.

Gordon Tullock I have a question, and I think it is sort of a by-product of something you said at the beginning. You remarked about loaning money to university students. I have always rather admired the Swedish system on this, on the grounds that it is much better than ours. Unfortunately, that is not very strong praise. Is it indeed true that they charge reasonable interest and then collect the loans?

Assar Lindbeck Zero real terms.

Gordon Tullock And do they collect the loans?

Assar Lindbeck Yes, they do. It is a problem with foreign students; they come in and then leave the country sometimes.

Gordon Tullock It is certainly better than providing the subsidized education that we do, in any event, even if the subsidy is only on interest.

Raymond Gastil A number of people at this conference have suggested that we should put more emphasis on economic rights such as freedom of choice, property and so on, in our Survey. Assar has convinced me that I am glad we didn't choose freedom of choice as a basic right. Ingemar's discussion gets us a little bit down the road towards understanding what a property right might look like as a basic right. He reminds us it is a bundle of rights, and I am reminded of the fact that in this case, as in so many cases in the real world, there is no country in which all aspects of property rights as he defines them exist in general, and there are very few countries where some aspects of property rights as he discussed them do not exist. So it is always a mixed system, but I thought it was a helpful classification.

There is one statement on page 13 that illustrates a point of view or way of thinking about majority rule that I have felt existed in a number of people in this group, and while I feel I am speaking into the wind, I will nevertheless make another intervention in this regard. The sentence starts:

To many economists a large public sector would mean a decrease in economic freedom. It is not equally obvious that a large government sector will mean a corresponding increase in political freedom. Only if one is a supporter of an extreme majority rule doctrine would this be true. The extreme case would be that all social states had to be ranked by a majority principle and that there were no areas of complete privateness.

To me, that discussion of majority rule is just odd. In the first place, you say that it is not equally obvious that a large government sector will mean a corresponding increase in political freedom. As far as I can see, it has no relationship to that subject. When you talk about majority rule, you are talking about something that a population *can* do by exercising its political rights. You are not saying anything about what it *will* do. So it *could* decide not to have any welfare state at all, or it could decide to have a quite developed welfare state. Extreme majority principle or not, I see no

way in which just invoking a majority principle gets us to a society in which there is no area of complete privateness. I just make the suggestion that my understanding of majority rule doesn't accord with this.

Gordon Tullock Once again I want to argue that aggregating preferences does not necessarily require that you use majority rule. It isn't a terribly good rule. But it is true that once you have decided to aggregate preferences and enforce the results of the preferences on other people, anything can happen. Majority rule is rather likely to lead to a lot of oddities. I have to emphasize only "rather likely," because the United States spent the whole 19th century under a very majoritarian system, and there was no expansion of the state during that period as a percentage of general income. But it is indeed true that majority rule has a tendency in any event to interfere in various places—the log rolling, special interest groups and so forth do occur. I would like a voting system that has somewhat less tendency to have that happen.

Many people think majority rule is what democracy means and, of course, they have a right to define words as they wish. What I want is a system which is in fact basically under control of the populace, and there are many, many voting rules that work better than majority rule for that purpose.

Ingemar Stahl The intention I had by this phrase—and it might not be quite clear—is a reference to the discussion by Amortia Simm on the impossibility of what is called "liberal preaching." The idea is that in an extreme case in welfare state economics there are ideas that can describe every socialist state. I might be able to read *Lady Chatterley's Lover* in one state and not in another. I think many politicians, even in the Swedish case, think it is better—we would get more democracy, they would say—if more decisions are majority decisions. That is why I am against it. I am opposed to the idea that they get more democracy, "more political freedom" as some people would say, if we put more and more decisions under majority rule. I am opposed to that idea because I believe in the unanimity rule.

On another point, the difference between my way of discussing it and Assar's way is that Assar is immediately going to the choice set. Freedom can then be defined as the size of the choice set.

Assar Lindbeck And its properties in general.

Ingemar Stahl Yes, but you can't say "properties in general." What I wanted to indicate by the first eight pages in my paper is that if we are going to have a discussion of rights—property rights, contracts—we have to look upon the relation structure which is very important. I might have failed a little bit there. Some of these ideas are extremely difficult, and I don't really know if they can be applied generally. For example, the choice set is determined in a very liberal world without any state interference. Then, using my terminology, we would say that I have a claim on government that they should provide me with free health care. There is a corresponding duty for the government to provide me with health care. But at the same time there is a claim from the government on me that I shall pay tax. The choice set is exactly the same as before. So you can't define freedom from the size of the choice set.

You have to go into the relation structure; that is, how many contracts, claims, immunities, et cetera you have against the state. It might be easier if you think it's only the relationship between me and the state that matters. But as in the Swedish case, we should broaden this because many of these freedoms and rights are against other types of institutions like trade unions and pressure groups. If you go to medieval society—and I guess Douglass knows much more about this—you really have to be careful to speak about rights and the relationships between different institutions and different persons. You don't need to mention very much about relations if it is just between you and the state. In a completely totalitarian state that might be true. But the more complex the state is and the more different pressure groups there are, the more we have to stress the relation and the contract structure, because they may differ very much between different persons or the relationships might change between different sub-sets of persons.

Svetozar Pejovich Suppose that only people who have high school degrees or only those whose wealth is \$100,000 or more have the right to vote, would you still be against the majority rule?

Gordon Tullock I would not regard it as optimal, even with those restrictions. By the way, you will find discussions of this kind of thing in the formal literature. If I may answer this, in a way it means that the outcome is more informed. But any restriction of the total number of voters means the outcome is more informed, because by increasing the weight of the vote you increase the likelihood...

Assar Lindbeck But there is a difference. If you give the right to vote to school graduates, then it is more informed. If you give it to those with

\$100,000 or more in wealth, you are simply giving the right to vote to those who have more at stake in protecting the status quo.

Gordon Tullock There is a disadvantage, which is that the small group has a strong motive to cheat.

Voice I want to go back to the matter of Assar's freedom of choice approach, and it seems to me that Ingemar is correct. As I heard it, Assar was equating freedom of choice with what I thought was almost a Pareto-improved situation. He was saying, if the state by doing something can make people better off, then that is the same thing as extending the freedom of choice. That's how I heard the examples. The loans for students would be a case in point. That would be a case in which things would be made better if the loans paid for the full cost of the education not just for support, and if the rate of interest reflected the opportunity cost of the funds and the cost of collecting them and the probability of default and so on. Then I could see that there would be an improvement in that case.

There would be other cases that go the other way. Assar suggested that public monopolies were perhaps a source of reduction in freedom of choice; that might in general be so. As a matter of fact, you could imagine situations in which it would be possible to have marginal cost pricing on some natural monopoly product that might not get organized that way if it was not provided by the state.

To be succinct, the basic idea that freedom of choice is the same thing as a Pareto improvement came across to me. I would like some clarification, perhaps, that Assar doesn't have that in mind. And secondly, examples to illustrate.

Assar Lindbeck I am not sure that I can give a satisfactory answer, but what I tried to do was to start with a more common sense approach that is easy to fill with empirical observations. What I want Doug to do is discuss the welfare state consequences for freedom of choice, which means that I would concentrate from the beginning on how interventions of the state influence freedom of choice. Then I thought, and I still believe, that it is very reasonable to say that if the marginal tax rate is 100 percent, an individual is not able to choose between leisure and income—he's stuck. I think that is a good starting point. Then say it is 90 percent, then his freedom of choice is very limited. Then you say that Pareto improvement is very much related to increased freedom of choice. I have nothing against that interpretation. What's wrong with that? Increasing the freedom of choice in the sense that the set will increase will often lead to a Pareto im-

provement. Still, I think it is very useful to define this as something that changes the freedom of choice.

I would say the same thing when you have price controls. Public authorities start to ration goods, and individuals still cannot decide for themselves if they are going to use their income to consume more goods. I think it is very reasonable in connection with common sense to say that the individual's freedom of choice between beef and apartments has been reduced by rent control. I am not going to give up common sense because, first of all, common sense makes sense, and secondly, it is not very common.

Ingemar Stahl There is no difference between Assar and me when it comes to giving a description of the Swedish case in everyday language; I agree on most points. In this paper I tried to be a little more careful when it came to discussing what rights and structures and contracts might be. Take an extreme example here. In my terminology, I have the liberty or power to use one special field for my sheep, and everybody has that power and liberty. I can use it, you can use it, everybody can use it. It is complete freedom, because everybody has this choice set. There would be immediate conflict.

Most of us would then say that it is better that I have a claim right on the land and you have a duty not to trespass on that land with your sheep. That is a restriction of freedom which is very good for many reasons because it defines property rights. So we have to be a little bit careful here when we talk about the choice set for everybody as a definition of freedom. This is still an open question, but I think we have to go through the hard work of contractual structures of society. My idea is that when we look at the contractual structure of the welfare state, it is like a network with many bonds between individuals and institutions. It becomes a very stable system where there are very few liberties in the sense of powers that can change your position. The type of topological idea I have is a society where all of these attributes are linked to each other with so many different contractual structures that it becomes extremely rigid. But that is a way of looking at it.

When it comes to descriptions, there is no difference between you and me. But this is the start of a research programme, and I think we have to be very careful when we use these words. We have to go far, far deeper than we were doing earlier to look at the contract structures and the rights structures. The idea I have here is that taking some of the research work from jurisprudence might help us a little bit. It is still a question. I am not quite sure that it is a good way, but we have to try it to see if it works. If

it doesn't work, it was an impasse. There are many impasses in scientific work.

Milton Friedman I want to go in a very different direction. I want to get back to some common sense and ask about some features of the welfare state that I think some of us are curious about. I have two in particular that I want to talk about, but I am only going to talk about one at the moment and that is the underground economy. One of the effects, obviously, as you were saying before, of the conflict between civil liberties and the widening of administrative regulation is that you either have slackness or reduction in civil liberties.

One of the ways that comes out is in the fact that people engage in illegal transactions among themselves. I remember some eight or ten years ago when we were in Sweden being told by some people there about cases of architects trading architectural services for dental services and similarly strange barter arrangements like that. I understood that there was widespread evasion of taxes via payment in cash as opposed to cheque. They called it "off the books."

This is purely an inquiry for information from both these gentlemen who are knowledgeable about this. Number one, what has been happening to the extent of that activity over a period of time? And second, how important do they estimate it to be in a sort of broad way? I'm not asking for an Ed Feige estimate of the percentage of the underground economy as a numerical value, but just your own conceptions of how important and significant it is and how much it limits what government is able to do.

Ingemar Stahl Every foreign opinion about the Swedish underground sector is exaggerated for two good reasons. One is that the control apparatus of the state is enormous in the sense that our social security numbers are used everywhere—on income accounts, on bank accounts, et cetera. As soon as one part of a transaction is controlled, the other part will also be controlled. That system, instead of sales tax, also has some self-controlling features, so you could say that tax administration is extremely skillful in Sweden. There are the service sectors, but remember that many of these, such as day care centres, are in the public sector. There is no way to do it in the underground sector.

I think the most important effect of taxation is that Swedes are working for themselves, not exploiting the possibilities of exchange. So we are getting back to a kind of do-it-yourself attitude. There may be more losses because of the lack of trade with everybody doing things themselves. And, of course, with high marginal tax rates you can only exploit productivity differentials where you have them six times in favour or against yourself.

We don't look for differentials where it is just twice. That is why we don't have a private service sector; that's the do-it-yourself sector in Sweden. There are a lot of possible exchanges which do not take place where there are reasonable but not large productivity differentials between the trading partners.

Assar Lindbeck Some 85 percent of the labour force work as employees. To the extent that they work for the government or in large firms, the possibilities for tax cheating in their ordinary activities are extremely small. The main area where you have cheating is in small enterprises in the service sector. The restaurant sector is probably at least 50 percent in the black sector.

There have been attempts at estimates, using various types of figures, for instance, government sampling studies in different branches. One of Ingemar's colleagues came up with between 4 and 8 percent of GNP, which probably is a more reasonable figure than Feige's 30 percent, which used a rather reckless method. I think he used currency circulation figures, and that is influenced by so many other things that it is not very reliable.

Two things happen here. One is that honesty becomes very expensive in the system, and there is a reduction in general morale. Twenty years ago people never boasted at the lunch or dinner table that they were cheating on taxes; they do that today. Also, of course, there is a substitution effect in favour not only of tax cheating but also of activities where tax cheating is easier than in other areas, such as drug peddling and things like that.

The biggest effect is perhaps what Ingemar said a little about, and that is the division of labour between families and markets and the government. Earlier, the family was in charge of personal services—it took care of the kids, the sick, and the old—whereas now these services are in the market. Now, a high marginal tax rate means that it is really impossible to buy services in the market with things or services produced in the household. The expansion of public services for individuals, like child care and old age care, rests with the government. Personal services are provided by government institutions, while households are taking care of *things* rather than human beings. We used to think that families were the natural units to take care of people, but now government is doing that. To me that is the most dramatic effect of the welfare state.

Milton Friedman I just want to pursue this two steps further. Number one, you didn't mention the extent to which you have a black market in rent control in housing. And I am just asking the question, is that an issue or not? The second thing is what you say about family seems to me more general. Every socialist regards the family as the primary enemy of the

state, and almost every socialist measure is designed to reduce the role of the family. What you are saying is that the Swedish socialists have been very effective in doing that.

Assar Lindbeck Yes, in an interview some time ago I said that in Sweden we have not socialized production firms but socialized households instead. That is what I meant by that. It is household income, and the services which earlier were pursued by households, that are now done by the government.

There are two very large areas of black market activity. In spite of public day care centres, the system is not complete because it is so extraordinarily expensive. It costs some \$10,000 per child, so only 40 percent of families get their children in public day care centres. Much of the rest is in the private sector with people taking care of other families' kids. That is not reported, and tax authorities never clamp down on that. So there you have a considerable sector.

It's quite true that you have rent control, and that means that contracts on apartments are sold regularly. Nowadays, that's mainly in the big cities. There has been so much house building in Sweden in the last 20 years that you have a pronounced excess demand rate only in the very big cities now. Isn't that true, Ingemar?

Ingemar Stahl Yes, in the two largest.

Assar Lindbeck Stockholm and Goteborg, there you have it. Having children myself, the expression I often hear when kids are working is that they work "stainless." Taxes are "stains," and if you work stainless that means you work in a sector where you don't pay taxes. That shows you the attitude among young people; they don't think it is immoral, anyway. Some people regard the politicians who created the tax system as more immoral than those who break the rules.

Voice I want to respond to Mr. Friedman's statement about the family and socialism. A study was made by a group of sociologists not so long ago saying that in the Soviet Union the family was a much stronger unit than in the United States. What Milton is saying is true, because at the same time that we had that strong unit, kids are encouraged to speak out about their parents behind their backs and to send them to gulags. The problem with our sociologists is that they simply report what they see; they don't know how to interpret it. There is strength in some ways, but at the same time confidence, trust and loyalty are totally broken.

Peter Bauer In considering the impact of the welfare state on the family we need to draw a number of distinctions. For example, we need to distinguish between redistribution of income and redistribution of responsibility between individuals and families on one hand and the government and its agents on the other hand. The two types of redistribution are quite different. I think redistribution of responsibility is a far-reaching effect of the welfare state.

Ingemar Stahl I think one could formulate a dilemma or a “catch 22” for the welfare state. If you ask people, why don’t you go to the opera or why don’t you buy that service or that service, they would say, I can’t do it because although my gross income is not that small my net income is so small that I can’t afford it. Then you might ask, if you can’t afford it, why do you pay so much in taxes?—because we require all these services from the government. It is a vicious circle. I think this process can explain the growth of the welfare state.

We mentioned two things regarding the underground economy. The first was that in the controlled state the controls are very tough. The second is the do-it-yourself economy, and I forgot to mention the fringe benefits. When you have a marginal tax rate of 85 percent, you have to be very careful to put your expenses on the expense account and regard them as an input cost in the firm. You don’t put it down as your own consumption but as an input cost. If you go to a Swedish hotel desk in the morning, people will always try to get the newspaper on the bill because it is six times more expensive to pay for it yourself. If you go to some countries, it is extremely difficult to get a receipt from a taxi driver. The first thing a Swedish taxi driver will offer you is a receipt. You can even trade in receipts. The fringe benefits economy is extremely difficult to estimate. There are some indications, however. For example, Swedish offices are in general much nicer than American offices. We will have a nice carpet in the office, but we can’t afford it at home.

Assar Lindbeck And two Swedes at this conference. (Laughter)

Alan Walters Peter made a point that I thought was rather minimized by Assar and Ingemar. This issue about the responsibility chain changes things dramatically, and I will give you an illustration. The health service in Britain is primarily organized for the doctors on behalf of the doctors—in fact, not just the doctors, but the super doctors called consultants—a very small group. The whole structure of care is both constrained and distorted. For instance, if you want a hernia operation in Britain, you probably have to wait four or five years, because the consul-

tants are not interested in hernia operations. They are more interested in things where they can come to distinguished conferences such as this. Consequently the whole structure is distorted and corrupted. Education is another typical case. The Inner London Education Authority, for instance, which is the biggest education authority, is corrupt in every sense. An enormous amount of money is spent—roughly twice the expenditure per pupil as anywhere else in the country. The whole structure of education is dominated by the providers who are organized by left wing...

Voice University of California faculty. (Laughter)

Alan Walters You probably *do* teach those things.

Not only has education been a failure in the sense that the kids can't read and write—not just that—but their minds are substantially distorted by preaching of the naturalness of homosexuality, of anti-white racism, of the irrelevance of much of the normal moral code. These politicized groups of providers manipulate education for their own ends. By dint of their contacts and infiltrations into the various power groups, extremists become the dominant teachers of the welfare state.

It is very difficult for the press and the normal organs of a democratic society to root out this corruption. One of the ways that was suggested for education was to get parent power back into the schools. This is extremely difficult in Britain.

Raymond Gastil Let me just suggest that from the point of view of the Survey, I have noticed that Sweden seems quite different perhaps from other similar welfare states such as Norway, Denmark, and the Netherlands, particularly in regard to the family. We brought up the family a minute ago, and there seems to be some evidence that the percentage of children that are taken over by the Swedish social services and taken away from their parents is several times greater than in those other countries. So I just wanted to point out that there are some real differences between welfare states that otherwise would seem to be very similar.

Herbert Grubel This is a brief technical point. When the state provides services which previously were provided by the household, one important effect is an upward bias in the estimate of national income growth. This happens when the supply of government child care induces women to cease the production of child care in the home and instead to supply their services in the market. One can perceive that the state supply of child care occurs with the labour which becomes available by the entry of the women

in the market. There is no net gain in output except to the extent that there are economies in the public as against the private production of child care or that the productivity of women is raised by specialization. But since child care in the home is not recorded in the national income accounts and government provided child care is, the main effect of the government supply of services is an increase in the statistics of national income.

I also have a question for our experts from Sweden. To what extent are the people of Sweden aware of the costs of the welfare state that we have been discussing, lower real income and loss of freedoms? Is the subject discussed in the media and by politicians?

Milton Friedman I was going to raise an issue which we can't go into here. I am always astounded in the United States, let alone other countries, that everywhere I see waste and yet everywhere I see a high standard of life. The problem is, how do I reconcile these two? Is it really true that if we used our resources efficiently we could have three times the standard of life we have now, because I think we are wasting an enormous amount of resources in all these various ways. The same thing is true here, the same thing is true in Sweden.

I was going to ask our Swedish experts to what extent they believe that the change in the conduct of the welfare state has led to a reduction in the standard of life below what it otherwise would be. By standard of life I don't mean the numerically calculated statistical GDP, because I agree with Herb. I think that is very much distorted in a society like Sweden, when you count government services at cost and you don't have a decent way of indexing it for inflation and so on. So I am really asking for a different kind of impression—a more qualitative, intuitive impression—than I am for a statistical survey.

Brian Kantor I would like to return to the point I raised the other day in terms of how the system affects the economic outcomes and therefore the dangers in the welfare state for democratic processes. I am getting a strong impression here—and I would like our friends from Sweden to answer this question or confirm my impression—of a great big merry-go-round. The people are putting in taxes and taking out pretty much in proportion. When colonels and university professors are paying very high average tax rates and are on welfare, what are the redistribution effects of that system? It doesn't seem to me as if there is very much redistribution—enormous amounts of efficiency losses, but not redistribution.

Assar Lindbeck Quantifications have been done by the moderate cost of public funds approach, which is really that instead of Harberger triangles

you get Harberger parallelograms because you start from a distorted situation. The best studies indicate that if you look at the choice between work in the home and work in the market, the growth rate would have been cut down from 3 to 2 percent during the last 15 years—these are Ingemar Honsenschultz Steward’s figures.

I should say one word about what we call “cross-holding” in the system. It is true that the gross flows are much larger than net changes, but you have to consider that much of the welfare state is really redistribution over the life cycle of individuals. You get money when you are young and go to school; you pay net to the system when you are between 30 and 60; and then you get it back later on. Which means that the redistribution of wealth is much, much smaller than the redistribution of yearly income.

The redistribution effect on yearly income is extremely large. In an article in *European Economic Review* two years ago, I showed the difference between the income redistribution of factor income, disposable income, and per capita disposable income. It’s a fantastic difference. If you take the highest decile to the second decile, for instance, it is 160 to 1 factor income; disposable per capita income is about 2 to 1. But, you see, that is because that statistic is on yearly income. If you take a life income, the redistributions are much smaller.

Ingemar Stahl In a description of the welfare state and its internal dynamics, I would prefer to use a paradigm of the prisoner’s dilemma, in the sense that everybody is playing in the wrong field here because they believe everybody else is trying to make claims on the welfare state. Until now we have not been able to come to the conference table for a kind of disarmament of the welfare state. With this type of decentralized behaviour of different pressure groups, every group will continue to pressure for more from the welfare state under the assumption that the other groups are also doing it?

Assar Lindbeck And all the others pay.

Ingemar Stahl Yes. But that is part of the prisoner’s dilemma.

Some consequences of the welfare state have to do with the rights question, and I have mentioned that before. If you have an all-encompassing social welfare or social security system, people are not responsible and there will be a moral hazard problem. This creates a control problem for government. Our colleagues from the benefit/cost calculation-oriented departments always support different types of measures for government control in the lives of the citizens. If you go to a Swedish hospital, it

would say: “belongs to the County Council of Stockholm.” You don’t know if it’s the dress the patient has on or if it even might be the patient himself.

The Swedish law system is a typical statutory law system and not a common law system. This means that it is extremely difficult to get compensation, say, in a tort of negligence. In the court they would say you have already gotten it through the social security system. You can’t claim compensation again. This means that another type of moral hazard is created in the system.

I think some of these issues should be pursued a little bit more, because these are aspects of the social welfare state that are really not well studied.