The Political Economy of the Welfare State

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1. Pareto-Optimal Redistribution

In this paper I propose to examine carefully the implications concerning the voting franchise that are implicitly contained in the modern concept of Pareto-optimal income redistribution. This concept has been discussed at length in several papers in the late 1960s. I share some of the responsibility for generating this interest. In my early review of Musgrave's treatise,[1] I called explicitly for the derivation of a conceptual logic for redistribution that is on all fours with the logic for allocation in the public sector. It seemed inconsistent to me to adopt the stance of modern public finance theorists, exemplified by both Samuelson and Musgrave in somewhat different ways, who attempt to derive criteria for public-sector allocation from individualistic valuations but to reject these criteria for public-sector redistribution.[2] Hochman and Rodgers, in their much-cited paper, and Edgar Olsen, independently, responded directly or indirectly to my suggestion. They attempted to construct a "theory of income redistribution" or a "theory of transfers" on the basis of individual utility interdependence.[3] This "theory" is open to either positive or normative interpretation, as "explaining" what is observed to take place through the fiscal process or as indicating what should take place under a regime characterized by utility interdependence of the sort postulated. Implicit in either interpretation, however, is the limitation of membership in the "fiscal club" of donors or potential donors. *To the members of the donor group,* whose utility functions contain arguments for the income or utility levels of other persons who are poor, the transfer of income to the latter group becomes a purely "public" good. And because of the jointness and nonexclusion attributes, a case is established, prima facie, for cooperative action, whether this is organized voluntaristically or politically.

If collective action takes its organizational form via political or governmental process, however, implications for the voting franchise are raised at the outset. If, in fact, the political decision mechanism is to serve, even to some remote approximation, as a surrogate for the idealized collective-cooperative fiscal club of potential donors, the voting franchise must be restricted to potential taxpayers, to those whose utility functions contain or might contain arguments for the income levels of poorer members of the larger community. Those persons to whom income transfers are to be made cannot be

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allowed to participate in the collective decision concerning the extent of this transfer itself since their own private interest will, of course, be unidirectional.

Elementary Analytics

Consider a community of $n + 1$ persons, composed of n i's and a single j. Each of the i's ($i = 1, 2, \ldots, n$) has the same utility function, which contains an argument for the income of j, designated in an all-purpose consumption good which also is the numeraire,

$$U^i = U^i(Y^i, Y^j), \tag{1}$$

where the Y's represent all-purpose consumption goods. Since the Y^j enters the utility functions of all i's, and since it is nonpartitionable among the i's, it qualifies as a purely public good in the Samuelsonian sense. The necessary condition for efficiency is familiar,

$$\sum_{i=1}^{n} \frac{u^i{}_{Y^j}}{u^i{}_{Y^i}} = 1, \tag{2}$$

where the small u's refer to the partial derivatives of the utility function. This condition states that the summed marginal evaluations over all i's, evaluated in the numeraire, equals marginal cost, which is simply one, owing to the monetary dimensionality of Y^j.

The satisfaction of (2) may be but need not be accompanied by the fulfillment of (3),

$$\frac{u^i{}_{Y^j}}{u^i{}_{Y^i}} = \frac{1}{n} \text{ for all } i. \tag{3}$$

If (2) is met, the Pareto frontier is attained since there exists no means of shifting from this position so as to improve the position of any person without harming another. All gains from trade in the most inclusive sense are exhausted, and, even allowing for full side payments at zero transactions costs, there is no proposal for change that could command unanimous agreement of all parties.

Note, however, that this seemingly straightforward application of the standard norm for public-goods efficiency does not contain the evaluation placed on the income transfer by the potential recipient, j.[4] Since we are treating transfers of income or general purchasing power, it is clear that the marginal evaluation placed on a dollar's additional transfer by j will, at all levels, be a dollar, or

$$\frac{u^j{}_{Y^j}}{u^j{}_{Y^j}} = 1. \tag{4}$$

If we now incorporate this evaluation of j into the summation over all members of the community, the necessary condition for efficiency seems to become

$$\sum_{i,j=1}^{n+1} \frac{u^{i,j}{}_{Y^j}}{u^{i,j}{}_{Y^i}} = 1. \tag{5}$$

But (2) and (5) are not satisfied at equivalent levels of income transfer to j. In order to satisfy (5), the summed marginal evaluations over the i's alone must equal zero, or

$$\sum_{i=1}^{n} \frac{u^i{}_{Y^j}}{u^i{}_{Y^i}} = 0. \tag{6}$$

When (6) is met, there is no utility interdependence at the margin. Note that *both* (2) and (5) describe positions on the Pareto welfare surface. These positions do not, of course, exhaust the Pareto set. *Any* level of income transfer at or beyond that which satisfies (2) will produce a result that qualifies as a Pareto-optimal position. Once attained, there will exist no means of changing or shifting from any such position under an idealized unanimity rule, when *both* the i's and the j's are franchised.

If the evaluation of recipients is included, note that (5) is *not* a necessary condition for Pareto optimality. Summed marginal evaluations need not equal marginal cost. This apparent paradox arises from the particular nature of pure income transfers, and this nonuniqueness in outcomes makes the application of the standard tools difficult. For purposes of comparison, consider the collective or public provision of a lighthouse-type purely public good. In this latter instance, absent transactions costs and income-effect feedbacks, any departure from that allocation which satisfies the equivalent to (5) will set forces in motion that will return the system to the unique position where (5) is met.[5] No such equilibrating forces can emerge with pure income transfers because, despite a possible willingness of the donors, as a group, to offer amounts differing from a dollar for a dollar's change upward or downward in the amount of income transfer, such offer cannot be accepted by the recipient(s) since this total, also, must be computed as part of the transfer. In one sense, therefore, the condition defined by (5) alone is meaningless because, operationally, it is not different from any other among a subinfinity of positions.

By contrast, for the i's treated as a group, the members of which evaluate the transfer of income to j as a public or collective-consumption good, condition (2) is fully analogous to the orthodox efficiency norm in public goods provision. Any change from that position defined or described by the satisfaction of (2) will set equilibrating tendencies in motion that will shift the outcome back to the equilibrium position, provided, of course, that the restricted assumptions about transactions costs and income-effect feedbacks are maintained.

Public Choice Implications

The formal analysis is simple enough, but its implications for the problems of collective decision making must be examined. Three quarters of a century have passed since Knut Wicksell admonished his fellow economists for their failure to relate economic policy norms to the political setting within which policy takes place.[6] He accused economists of assuming that policy is made by an "enlightened and benevolent despot," whose criteria are those provided to him by pure-minded professors. Wicksell's strictures are almost wholly applicable in the current professional and quasi-professional discourse on income redistribution policy. The pros and cons of the various income maintenance plans, sometimes called negative income taxes, are discussed with little or no reference to the political choice process.[7] In this context, the preliminary attempts to develop criteria for politically implemented income redistribution from individual evaluations represent advance over the naiveté inherent in the invocation of external value norms. These attempts have remained seriously incomplete, however, because of the failure to relate the analysis directly ot the political decision mechanism, either that which is potential or in being.

In order to discuss this relationship systematically, it is useful to digress briefly and summarize the elementary methodology of the Pareto criterion itself. An initial or existing state of the economy is described by an imputation (assignment, allocation, distribution) of "goods" (positive and negative) among persons in the relevant community. In the normal case, individualized shares in total product are assumed to consist in full-fledged claims to the disposition of "goods" as their "owners" see fit, although behavioral limitations may be incorporated into the definitions without difficulty. Similarly, the "goods" are usually assumed to be fully partitionable among separate persons although, once again, the existence of joint and common ownership rights may be embodied in the appropriate definitions. In all cases, however, the imputation defines a structure of rights or claims that is presumed to be known with certainty. If individuals are informed about the qualities of the "goods" assigned to them, and if they are assumed to be rational utility maximizers, the private behavior of each person carries him to what we may call the nonexchange utility possibility frontier. That is to say, all gains from internal "trade" will be exhausted in the private or presocial behavioral calculus of individuals.

The Pareto criterion, whether applied to a classification of final positions, described by imputations of "goods" among persons, or to a distinction among changes from one position to another, is rooted in interpersonal or social *exchange*, the central institution that is analyzed variously in economic theory. Given any imputation, the Pareto criterion enables us to classify this into the nonoptimal or the optimal set.[8] If it is nonoptimal, it enables us also to classify proposed moves or shifts as efficient or inefficient. The criterion can be applied positively to the observation of behavior as well as conceptually on the presumption that individual utility functions are known. Individuals, endowed with initial imputations, are presumed to engage in simple or ordinary trades that will shift the system in the direction of the Pareto frontier, exploiting the potentially available surplus obtainable. The Pareto norm can be utilized to assess the results of such trades, but its potential usefulness is found largely in the location and isolation of possible complex trading arrangements that may not emerge from the simpler trading processes. These complex trading prospects may, and normally will, involve simultaneous agreement on the part of more than two parties, and they may include trades in the form of "agreements" to change the rules or institutions within which orthodox trading can take place.

The Donor Cooperative or Club

If this summary description of the Pareto criterion is provisionally accepted, what can be said about "Pareto-optimal income redistribution"? Commencing from some initial imputation, unilateral transfers in some numeraire good (income) might be observed to take place voluntarily if utility functions exhibit interdependence.[9] Some such transfers would take place under wholly independent behavior but, as noted, there may exist both jointness and nonexclusion attributes that suggest superior results from joint or cooperative action. Potential donors would, in this setting, organize and join a voluntary cooperative for the purpose of making transfers to those persons designated as being eligible for "charity." The latter would, however, remain external to the acting donor group or club, and these recipients would treat the transfers as purely gratuitous. They could scarcely be expected to participate in decisions concerning the amount of transfer they receive and, of course, their evaluation of the transfer will not directly influence the decision of the donors.

Within the cooperative donor group or club, decisions must be made on the amount of transfer along with the distribution of the costs among individual members. In aggregate terms, the necessary condition for efficiency is that defined by (2) above. In a setting without decision-making costs, the group would operate under some effective rule of unanimity. Condition (2) would be satisfied, along with that defined in (3) for a set of equal i's. If members of the donor club should differ in preferences for income transfers, the equivalent of condition (3) would, of course, involve differing marginal costs among members. Decision-making costs exist, however, and these become significant where groups must reach agreement. Hence, even in purely voluntary donor clubs members might acquiesce in agreed-on, nonunanimity decision rules. Departure from unanimity removes any assurance that the aggregative marginal condition for efficiency, defined in (2), will be satisfied, or that the individualistic marginal conditions, defined in (3) or its equivalent, will be fulfilled. The voluntary nature of the arrangement embodied in the right of any member to withdraw unilaterally insures, however, that each person secure net gains from his participation. That is,

$$\int_0^T \frac{u^i y_j}{u^i y_i} \geqslant 1, \tag{7}$$

for all i's, where T measures the amount of income transfer to j by the fiscal club of the i's.[10]

In this more comprehensive setting that does allow for decision-making costs, the level of income transfer from donor groups to recipients under a regime of voluntary cooperative groups might appropriately be designated as "Pareto-optimal." Conceptually, this seems to have been the organizational model assumed by several of those who have participated in the recent discussion.

Governmental Analogues to Voluntary Donor Cooperative

The observed institutional framework for much income redistribution is not voluntary; it is political or governmental. The analysis must somehow bridge the gap between voluntary and coercive organizational structure. How can analysis based on voluntary exchange, and utilizing the Pareto criterion, be extended to apply to political or governmental structure, since the latter must be, in its nature, coercive?

There are three institutions that would allow governmentally determined income transfers to be brought under orthodox Pareto norms, and to be treated *as if* such transfers emerged from voluntary fiscal clubs with only minor variants. In each case, we make the preliminary and necessary assumption that decisions are made democratically through some voting process in which many persons participate, directly or indirectly. This rules out authoritarian decision making on the part of governments.

Model I. In the first model, we can assume that a genuine rule of unanimity is operative, at least with respect to redistribution policy, and that all persons in the community have the voting franchise, both potential donors and potential recipients of transfers. The restrictiveness of unanimity may be relaxed sufficiently to allow for representative processes provided that the legislators selected represent all interests and that the unanimity requirement holds within the legislative assembly.

Commencing from an initial imputation of goods among persons, and with no voluntary redistribution, we may consider the results of an idealized decision process. It is clear that representatives of donors and recipients would agree on a level of income transfer that would satisfy condition (2) above. Proposals for additional income transfers beyond this level would be opposed by donor interests. Such extensions would, of course, be supported by representatives of recipient groups, as indeed would all proposals for additional transfers within meaningful limits. The political process would in this model accomplish essentially identical objectives as the cooperative or voluntary clubs organization discussed earlier. In practical fact, however, a political decision structure organized in that fashion would probably generate a lower level of total income transfer than the alternative regime of wholly voluntary fiscal clubs. In the latter, the voluntary participation feature would make individual donors more acquiescent in departures from effective unanimity as a means of allowing some reduction in group decision costs. In political organization, departures from unanimity would be more strongly resisted.

Model II. Consider now a second model in which politically determined income transfers might be discussed in an orthodox setting of Pareto optimality. If a regime of competitive governmental units exists, and if persons may shift membership among these at relatively little personal costs, each political unit may embody both an inclusive voting franchise and departures from an effective unanimity rule for collective choice while generating results that are akin to those broadly predictable under voluntary organization. This model is applicable, however, only in those situations where the utility interdependence, if such exists, involves members of the same "local" governmental jurisdiction. In this sort of setting, income redistribution takes on most of the properties of a "localized public good," and a Tiebout-like adjustment process places severe limits on the possible inefficiency that can emerge regardless of internal political decision rules.[11]

Model III. A third model is one in which the voting franchise is specifically limited to those who are actual or potential contributors or donors in the income-transfer system, that is, net taxpayers rather than net beneficiaries. In this model, those who receive income transfers are explicitly excluded from participation in the collective or governmental decisions that are concerned with either the level or the financing of the transfers. In this setting, income transfers to the "poor," treated here as an external group, can be analyzed as a purely public good whose benefits and costs are shared among members of the potential taxpayer, and hence voting, group in the community. If, among this restricted set of persons, an effective rule of unanimity prevails for collective decisions, a regime closely analogous to that of voluntary clubs exists, with the differences previously noted. If the costs of decision making suggest significant departures from unanimity, and if individual members of the group do not have available low-cost migrational alternatives, the moves or shifts in income distribution emerging from the political process may not be Pareto-superior. If, for example, a majority coalition among the potential taxpayer group desires to redistribute substantial income to the poor outside the voting group, at the expense of all potential taxpayers, the minority of the latter may suffer genuine fiscal exploitation. Nonetheless, the majority coalition need not act in such fashion, and the disenfranchisement of the transfer recipients removes the direct influence of those whose strictly private self-interest dictates extensions in transfers at all levels. Under such conditions, it seems plausible to treat observed political outcomes as indirect surrogates for something akin to genuinely voluntary transfers.

2. Property in Franchise

Observation tells us that none of the three models sketched briefly above describes the real world. What we do observe is politically determined redistribution of income at jurisdictional levels that guarantee high-cost migrational alternatives and under the operation of decision rules that are basically majoritarian rather than unanimitarian. We observe, furthermore, that transfer recipients are not excluded from voting and otherwise participating in politics, including the politics of transfer policy itself. In this realistic setting, the Pareto criterion must either be judged of relatively little value in analyzing transfers or it must be modified substantially from its standard application.

Recall our summary of the methodology of the Pareto norm. Individuals in the social group are described in terms of an imputation or assignment of "goods," with well-defined limits as to rights of disposition. The orthodox Pareto criterion assists in evaluating or in proposing changes that involve simple and/or complex "trades" in these assigned "goods" among separate members of the community. I now think that this traditional approach that has been taken by many political economists, including me, has been seriously deficient. The deficiency may be identified and discussed in terms of the problems considered in this essay.

Nominal and Real Claims

In the distributional setting as observed in the real world, "goods" are *not* partitioned among separate persons (families) in the well-defined sense that is implicitly postulated in the standard analysis. To indicate this, I propose to distinguish "nominal" and "real" imputations or assignments over final "goods," over rights to the use of "goods." What we may actually observe, at any moment, is a set of nominal rights, which may be defined by an imputation, which may or may not accurately map the initial position or basis from which simple and complex trades among persons must commence. Alongside and accompanying the set of nominal claims over "goods," there exists a *membership* right in the social group or community, which may or may not be accompanied by a *voting* right in group or collective decisions. Both the membership right and the voting right have economic value to the holders, an economic value that takes its meaning in terms of some contingent claim on the "common fund" of "goods" available in the whole community.

Membership rights and voting rights are separate, and, in some cases, the distinction is important.[12] But for our purposes these rights accompany each other; we simply assume that membership in the social group implies voting rights. What we observe, then, is a set of nominal claims, partitioned among persons and/or families in the group, along with universal and uniform voting rights (political equality) over all adults in the community. The latter rights take economic value in our model only through the indirect claims that they might represent over the total resource stock in the economy, all of which we assume is partitioned among persons in the nominal sense. For purposes of simplifying the analysis, we assume that there are no joint-consumption goods, no public goods of the standard variety.

Constitutional Restrictions

The value that a voting-membership right has for its holder depends on several things, including the allowable range for collective or political action. This will be defined by a political constitution, which may or may not be formally specified. We limit consideration in this paper to redistributional policy, and we specify the effective constitutional requirements to be as follows.

1. Income redistribution shall be general rather than discriminatory, and redistribution, if it occurs, must take the form of transfers from higher to lower income categories, with equalization as the limit.
2. No person in the recipient group who stands lower on the income scale before political redistribution shall secure less in total transfer than another who stands higher on the scale.
3. No person in the taxpaying group who stands lower on the income scale before political redistribution shall be taxed by a higher amount than another who stands higher on the scale.
4. Collective decisions are reached through simple majority voting.

These requirements seem plausible on their own account, as well as realistic if we confine attention to pure income transfer policy. Basically, these requirements state that arbitrarily composed political coalitions may not exploit minorities. "Regressive" and nondiscriminatory transfers as well as taxes are ruled out. Taken together, these requirements add stability to the expectations about redistribution policy, and they enable us to define more clearly the value of the membership-voting franchise.

No Production–No Utility Interdependence

I assume initially that there is no utility interdependence of the sort adduced to "explain" observed income transfers under the orthodox Pareto constructions discussed in section 1. In the absence of collective action, therefore, each person (family) retains all the "goods" under his assignment in the nominal sense. I assume, further, that agreed-on laws against theft are enforced perfectly. Finally, I assume in this model that the initial assignment of "goods" falls as manna with a distribution that is unchanging from one period to the next. "Goods" are not "produced" by human effort.[13]

Under the restricted conditions postulated, simple majority voting will generate an amount and type of income redistribution determined by the median income recipient acting to further his own position. His problem is one of simple maximization subject to the constitutional constraints imposed.

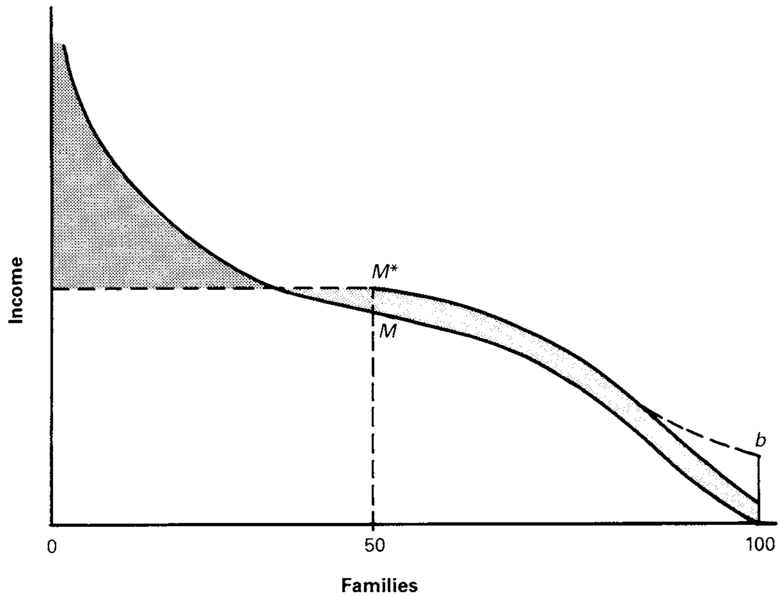

Fig. 1

In the no-production economy majority voting will tend to equalize all post-transfer incomes above and including the median and to equalize all positive transfers to persons below and including the median.

Figure 1 depicts family distribution in a community in a shape that is similar to that which describes distribution in the United States. The median is located at *M*. If, in fact, this pattern should describe a distribution in a no-production setting, and if the constitutional limits were those indicated, the posttransfer income distribution would be shown by the dotted curve. The transfer to the median family, measured by *MM**, would be maximized subject to the constraints suggested, including the necessity that the two shaded areas be equal in size, that is to say, that the transfer budget be balanced.

We may now look at the value of the voting franchise to a person along the income scale in this model. It is clear that the franchise has value only through its indirect influence on the location of the median voter. Disenfranchisement of, say, persons at the lower levels of income would shift *M* to the left on the diagram and the distance analogous to *MM** would be smaller. This would impose monetary costs on all transfer recipients, not only those who might suffer disenfranchisement as such. Similarly, disenfranchisement of persons at the upper end of the scale would shift the median to the right in the diagram. This would increase the amount of tax paid by each taxpayer, increase the number of taxpayers, increase the total amount of transfer, and increase the positive transfers received per recipient.

It may be noted from the construction of figure 1 that, in the conditions of this model, the median voter will be harmed by the disenfranchisement of voters at either end of the scale; he will suffer from any shift of the median. A shift to the right will equalize incomes at and above the new median, but this must be at a lower level. A shift of the median to the left will reduce the total tax revenue collections while simultaneously increasing the number of recipients. This must involve a reduction in the amount of transfer per recipient, and hence the amount received by the initial median voter. It will not, therefore, be to the direct interest of the established median voter, presumed here to be the median pretransfer income recipient, to extend or to limit the franchise asymmetrically. He will, of course, be indifferent as to symmetrical changes.

No Production with Utility Interdependence

The introduction of utility interdependence into this model will have less effect on the results than might have been anticipated. The preference of certain upper-income receivers for greater amounts of transfer than that emergent in the no-interdependence framework will have an effect similar to their own disenfranchisement. The effective median position shifts to the right, with the results indicated above. Note particularly that this sort of utility interdependence will not allow for the inverse discrimination represented by larger transfers to the lowest pretransfer income recipients so long as the effective median voter's preference does not exhibit a concern for the utility of those standing lower along the pretransfer income scale. There will be no flaring of the dotted curve upward as traced out by the extended segment shown by *b* in figure 1. If such a flaring is to be produced, this must arise because of utility interdependence of voters in median income ranges, at least if we confine analysis to this very simple political choice model.

Production without Utility Interdependence

The introduction of production will drastically change the model. Instead of "goods" being initially distributed as manna, we now assume that "goods" are produced exclusively by human effort, and that the initially generated distribution is the same as before. In this model, the amount of redistribution that becomes rational for the median-income recipient, and voter, will be directly dependent on the incentive effects that taxation will exert on those from whom funds are to be exacted politically. It will clearly be inefficient to levy more than a revenue-maximizing tax on any person. Hence, we should predict that the posttax distribution of income will reflect some inequality throughout the scale under the constitutional restrictions previously postulated. Figure 2 depicts the situation. The curved line indicates the pretransfer distribution of initially received incomes *after* income earning adjustments to the transfers have been made. The dotted curve indicates the posttransfer distribution.

As in the no-production model, the median voter faces a constrained maximization problem. He will try to maximize the net transfer to him, shown

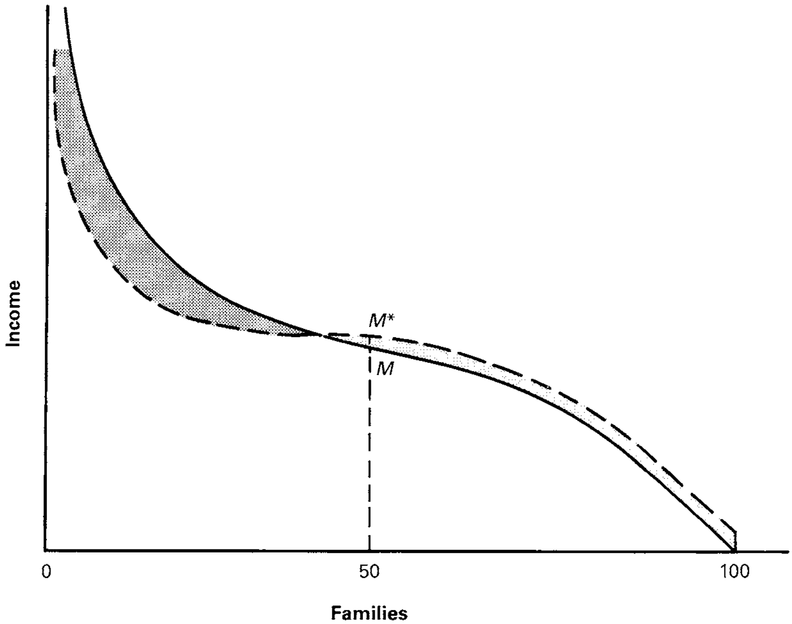

Fig. 2

by MM^*. Let us assume that the dotted curve over the net taxpayer group represents the strict revenue-maximizing locus. We want now to examine effects of a shift in the franchise as before. If persons at the lower extremities of the scale are disenfranchised, the median shifts to the left, as before, but note that this will have no effect on the total tax levied on those at the upper extremities of the scale. This is because these persons are, in all cases, being subjected to the revenue-maximizing tax. Shifts in the median will not, therefore, modify their final positions. In such case, however, these highest-income recipients will be totally indifferent as to whether or not they exercise their own franchise. The vote will have no value to them and they may be observed either to neglect the exercise of franchise or, more likely, to fulfill a presumed internal moral commitment by affecting to exhibit great concern for those at lower income levels.[14]

If this reaction on the part of the highest-income recipients is fully recognized by the median voter, however, this, in itself, will cause the latter to refrain from imposing taxes at the strict revenue-maximizing level. High-income recipients will be taxed at a level sufficiently below such limits as to insure their attention to the voting process. The potential upward mobility in the income scale that enters into the expectations of the median voter will also modify or mitigate against impositions of taxes at the revenue-maximizing limits.

In this model we should also note that changes in the location of the median voter along the income scale, brought about by voluntary voting abstention, utility interdependence, or explicit disenfranchisement, will not affect the net transfer to recipients at the lowest end of the scale nearly so much as in the no-production setting. Because the highest-income recipients are likely to be taxed at or near revenue-maximizing limits regardless of the location of the median, over broad middle ranges, this source of funds remains invariant. Shifts in the median will affect the transfer per recipient slightly, but the primary effect will be that of shifting the break-even position, where a person is changed from a net taxpayer to a net beneficiary of the transfer scheme.

Democratic Income Transfers and Pareto Norms

It is tempting to extend the majoritarian transfer models, to introduce further qualifications, and to modify the assumptions. All of this offers challenging subject matter for the application of the tools of public choice theory. My purpose here, however, is neither such elaboration nor defense of the particular models chosen. Rather it is to relate the basic majoritarian transfer process to the Pareto criterion framework within which income transfers were discussed in section 1. As noted, I now recognize a serious deficiency in the standard application of the Pareto norms, and I want to discuss this deficiency explicitly with reference to the models introduced here.

Orthodox procedure would classify the income transfers generated by the working of pure majority voting rules, or by any political process that may reasonably be described by this model, as being coercive in nature, and, as such, clearly violative of the Pareto criterion as the latter is applied to changes or moves among positions. That is to say, a pure majoritarian transfer of income under the constitutional restrictions suggested would qualify as a "nonsuperior" move. I now think that this is an overly restricted usage of the Pareto norm, even as applied to changes. As I have noted at several places, the Pareto criterion, strictly speaking, is applicable only when the nominal imputation of "goods" among persons represents accurately the "real" set of claims or rights of persons over the final disposition of these "goods." It is erroneous, however, to acknowledge a nominal imputation as "real" in a setting that allows for income redistribution under collective or governmental auspices.

Consider, for example, the position of a single high-income recipient. His nominal claim over the disposition of "goods" may be, relatively, very large indeed. But he secures (or earns) this nominal income in a polity (economy) that has extended universal and uniform suffrage to all its adult members. Furthermore, this recipient of the nominally high income cannot, by assumption, shift to alternative polities (economies) without undergoing major costs. In a very genuine sense, therefore, the high-income recipient does not possess a full-fledged "property right" to the "goods" over which his nominal income apparently gives him claim. By the very nature of their simple voting or potential voting membership in a polity (economy) that constitutionally allows income transfers to take place under collective aegis, *all* other members in the community hold a contingent claim on the "goods" purchasable by the nominal income of the person in question. Hence, to say that the recipient of a nominally high income actively opposes a majoritarian transfer policy that makes him a net taxpayer and that this behavior, in itself, reveals that the policy does not reflect a Pareto-superior move or change, tends to obscure the underlying nature or basis of the complex interaction that is involved here. The majoritarian transfer can be viewed merely as the working out of the "real" set of claims to income in the community, the revision in the nominal set of claims predictable under the political structure in being, which includes "property rights" in franchise. The observed opposition of the rich man to transfer policy is akin to that of the person who has to pay an obligation previously made. Since the nominal income is not "his" by any "real" rights of ownership in the first place, his opposition can hardly be adduced in evidence that the transfer is violative of a meaningful welfare norm. To the extent that such a transfer appeared to violate clearly the Pareto criterion, as applied to the orthodox sense, many economists have rejected the Pareto framework in application to the whole set of issues involving income redistribution. Having no alternative, many of those who reject the Pareto criterion have sought to introduce external ethical norms to apply to all redistribution policy.

My own work, as well as those who have advanced the analysis of so-called Pareto-optimal redistribution, has suffered in the opposite sense. Because political transfers seem to violate the standard Pareto norms, we have tended to opt out of any discussion and to say that nothing further can be constructed on the basis of individual evaluations. I now propose to modify this stance, and to do so in a substantial sense. Failure to carry out income transfer policy in a political setting such as that sketched out in the models above would represent a fundamental shift in the real assignment of rights, a shift in favor of those with the nominally higher incomes. Once the franchise has been extended to all adults, and once the constitution has allowed income transfers to take place collectively, the formal act of transfer becomes fully predictable from positive economic analysis. The basic property right inheres in the voting franchise, and the economic value of this franchise reflects the measure of the contingent claim to the incomes and wealth nominally imputed to individuals in the whole community.[15]

Pareto Optimality and the Status Quo

To this point, the income transfers from the nominally rich to the nominally poor that are predicted to occur under a democratic polity are derived from individual evaluations without normative content. The Pareto norms have not been utilized to evaluate these transfers, other than in the negative commentary suggesting their inapplicability. We may now, however, try to evaluate such redistribution in terms of the Paretian criteria. Is the institutional structure which embodies pure majoritarian transfers itself Pareto-optimal? Does there exist a means of changing this structure that is Pareto-superior; that is, does there exist any proposed change in constitutional-institutional rules that would, conceptually, command the assent of all members of the community?

At first glance, these questions may seem to reflect a return to the orthodox Pareto framework, which I have explicitly criticized. There is a major difference, however, which should be stressed. Paretian criteria have often been criticized because they lend support to the status quo. In a sense, this charge is correct, but my own response has always been that "we start from here," from the status quo, and, willy nilly, this constrains our analysis. The error in my own earlier methodological position has been my initial definition of the status quo, or starting point, in terms of a presumed imputation of "goods" among persons that ignores the political process in being and the genuine claims to "goods" inherent in this process.[16] This is properly to be regarded as much a part of the status quo as is any strictly defined nominal imputation. Having redefined the status quo, the Pareto criterion can be applied in the standard manner.[17]

It seems clear that any restriction on the voting franchise, once this has been universally extended, is nonoptimal; such a shift would harm some members of the community. Under universal franchise, we may then ask whether any of the constitutional constraints can be modified to the advantage of all parties. If we limit attention to income redistribution alone, and leave other collective activity out of account, there seems no apparent change that would qualify as Pareto-superior. If this is the case, the total regime as described can be classified as Pareto-optimal.

3. Impure Redistribution

The whole approach of section 2 may be questioned, however, as regards its descriptive accuracy. Can the political process that we observe in the real world be approximated in such models, even if we accept the necessity of extreme simplicity and abstraction? Presumably, little distortion is created by the assumptions of universal suffrage. Effective majority voting rules, even when the complexities of actual political decision making are acknowledged, seem broadly acceptable in the context of the discussion here. The presence of high-cost migrational alternatives can scarcely be challenged with reference to redistribution policy at the national government level.

More serious issues may be raised concerning the specific constitutional restrictions imposed on redistribution policy itself. We do not observe much "pure" income redistribution in the absence of collective provision of real goods and services. When the allocative role of the political sector is included in the analysis of distributional outcomes, quite different results may emerge. A more acceptable and alternative model would allow tax funds to be used (1) for financing publicly supplied or publicly subsidized real goods and services; or (2) for financing pure income transfers. In this setting, it may be to the advantage of the median voter–cum–income recipient to choose (1) rather than (2). This offers a means of escaping from constitutional restriction on regressively discriminatory transfers in the numeraire. While it may not be possible to discriminate in favor of the median voter by grants of larger absolute amounts of money than those offered to persons standing lower on the nominal income scale, the same purposes may be accomplished by choosing for public or governmental supply that set of real goods and services which is most highly valued by median voters. Once supplied, these goods and services may be available on equal terms to all members of the community, but the actual distribution of benefits, as valued, may be skewed dramatically toward middle income ranges.

This may be illustrated in figure 3. The curve Y_n, as before, depicts the nominal income distribution, after behavioral adjustments but before transfers. The curve Y_d represents the most preferred pure distributional scheme for the median voter under the constitutional restrictions imposed in section 2. The curve Y_p depicts the alternative curve of effective final distribution under the regime that allows for collective provision of real goods and services. Note that Y_p falls *along* Y_d over high income ranges, and *below* Y_d over low income ranges.

This alternative model of impure redistribution is in accord with the hypotheses advanced by Aaron Director, George Stigler, and Gordon Tullock, which suggest that the major beneficiaries of transfer policies are those in the median income ranges rather than the very poor. In neither of the basic models here do the "poor," as a group, possess decisive power via the

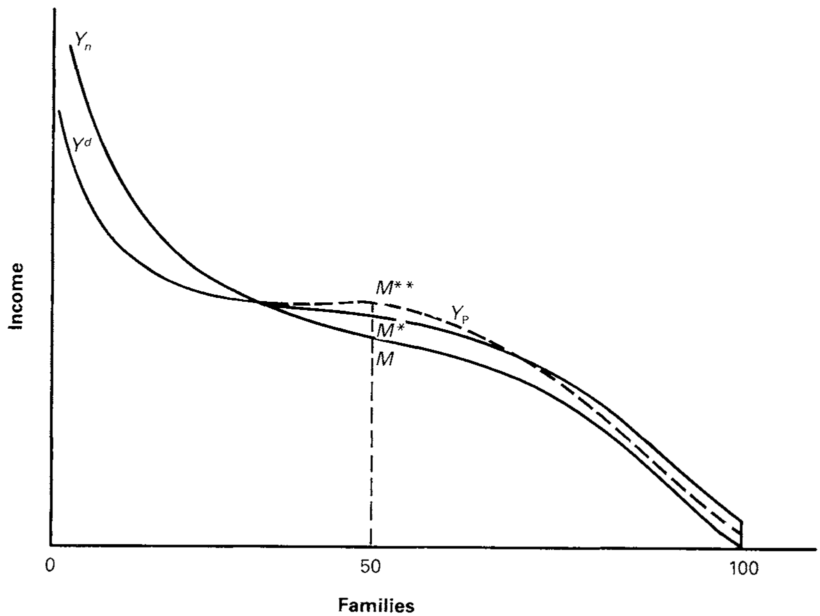

Fig. 3

voting process. Under a nondiscriminatory constitutional requirement, however, the very poor could do as well in terms of absolute pure transfers as median-income recipients. This outcome is circumvented to the extent that in-kind goods and services are offered governmentally that are differentially valued by the median voters. Public education, at all levels, seems to provide the example here.

4. Conclusions

Much of the confusion in the discussion of income redistribution stems from an inconsistency between our economic and our political attitudes. On the one hand, the ethics of capitalism suggest that the market earnings of resources become the property of the nominal owners, who may, presumably, dispose of these as they, personally, desire. They may, of course, elect to worry about their fellows, but in such an attitudinal framework "charity" is merely another consumption "good." Any politically determined transfer of income above minimal limits involves a coercive "taking." At the same time, however, the ethics of democracy suggest that restrictions on franchise are not to be tolerated. Few seem to have recognized the implications of the inconsistency between these value positions.

The inconsistency appears in its starkest form in redistribution policy, and it is the basis for the neoclassical dichotomy between allocation and distribution. Economists claim competence in defining and in identifying allocative efficiency, using as inputs the revealed (actually or conceptually) preferences (values) of individuals. They stop short when faced with distribution, and they often pull in external and nonindividualistic norms which they acknowledge to be less "scientific" than those introduced for the theory of allocation. Efficiency in allocation is defined to characterize a position where all of the potentially realizable surplus has been squeezed out of simple and complex trading arrangements. Essentially, this procedure is to describe the end point of a process, and economists have not carefully considered the starting point. Implicitly, they postulate an initial distribution of endowments and/or capacities among persons, and it is presumed that this imputation can be mapped directly into a set of final imputations of "goods" on the Pareto welfare surface. As noted, efforts have been made to bring this basic Pareto efficiency framework into the evaluation of distribution but without much success, largely because here too economists have not escaped from the inconsistency noted.

In this essay, I have tried to reconcile the inconsistency by going back to the starting point, and to call into question the orthodox definition of that imputation from which trade commences. If membership in a sociopolitical community carries with it a valued "right" of participation, this value must be somehow incorporated into any exhaustive partitioning of "potential goods" among persons, even if it is fully recognized that such value can, at best, be probabilistically estimated or determined. This procedure allows us, at least conceptually, to examine both allocation and distribution problems within a coherent analytical framework. The fact that the analysis, at all stages, becomes much more difficult, and perhaps less aesthetically satisfying, should not deter serious scholarship. Like it or not, we live in an environment where the workings and forms of capitalism are tempered by the workings and forms of majoritarian democracy.

NOTES

I am indebted to both Winston Bush and Gordon Tullock for comments.

1. "The Theory of Public Finance," *Southern Economic Journal* 26 (January 1960): 234–38.
2. In his now-classic formulation, Samuelson defined the necessary conditions for allocative efficiency with public-goods provision and then introduced a social welfare function to determine the final distribution. See Paul A. Samuelson, "The Pure Theory of Public Expenditures," *Review of Economics and Statistics* 36 (November 1954): 387–89. Musgrave was less willing to introduce external welfare norms to determine distributional outcomes, but his conceptual separation of the allocation and distribution branches of the budget suggested different normative principles. See R. A. Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill, 1959.)
3. Harold M. Hochman and James D. Rodgers, "Pareto Optimal Redistribution," *American Economic Review* 59 (September 1969): 542–57; Edgar O. Olsen, "A Normative Theory of Transfers," *Public Choice* 6 (Spring 1969): 39–58. The Hochman-Rodgers paper stimulated several comments, both in criticism and in extension. See Paul A. Meyer and J. J. Shipley, "Pareto Optimal Redistribution: Comment," *American Economic Review* 60 (December 1970): 988–90; R. A. Musgrave, "Comment," *American Economic Review* 60 (December 1970): 991–93; R. S. Goldfarb, "Comment," *American Economic Review* 60 (December 1970): 995–96; Harold M. Hochman and James D. Rodgers, "Reply," *American Economic Review* 60 (December 1970): 997–1002; E. J. Mishan, "Welfare Economics and Pareto Optimal Redistribution" (Typescript, June 1971).
4. This has, of course, been recognized. Cf. W. C. Stubblebine, "Redistribution and Wicksellian Unanimity" (unpublished note, University of Virginia, 1962); George E. Peterson, *Welfare, Workfare, and Pareto Optimality,* Working Paper 1200–12 (Washington, D.C.: Urban Institute, December 1970).

   For simplicity, we assume that j is not concerned about the utility of the i's. That is, j's utility function is written $U^j = U^i\ (Y^j)$.
5. This is the collective or public goods equivalent of the Coase theorem. Cf. R. H. Coase, "The Problem of Social Cost," *Journal of Law and Economics* 3 (1960): 1–44. In the transactions-costs rubric we must, of course, here include free rider and preference revelation difficulties.
6. Knut Wicksell, *Finanztheoretische Untersuchungen* (Jena: Gustav Fischer, 1896). Major portions of this work are published in translation as "A New Principle of Just Taxation," in *Classics in the Theory of Public Finance,* ed. R. A. Musgrave and A. T. Peacock (London: Macmillan and Co., 1958), pp. 72–118. The relevant passages are found on pages 82–87.

7. There are notable exceptions of this generalization, among which are the contributions of both George Stigler and Gordon Tullock. See George J. Stigler, "Director's Law of Public Income Redistribution," *Journal of Law and Economics* 13 (April 1970): 1–10; Gordon Tullock, "Welfare for Whom?" *Il Politico* 33 (December 1968): 748–61, and "Charity of the Uncharitable," *Western Economic Journal* 9 (December 1971): 379–92.
8. For background discussion, see Ragner Frisch, "On Welfare Theory and Pareto Regions," *International Economic Papers* 9 (London: Macmillan, 1959): 39–92; and my "The Relevance of Pareto Optimality," *Journal of Conflict Resolution* 6 (December 1962): 341–54.
9. Transfers of specific goods, income-in-kind, might also occur. These are not discussed in order to keep the basic analysis simplified.
10. In a regime of competing fiscal clubs each member must secure net benefits at least equal to that available to him from membership in any other club.
11. For further discussion, see Mark Pauly, "Income Redistribution as a Local Public Good," *Journal of Political Economy* 81 (February, 1973): 35; and my "Who Should Distribute What in a Federal System," in *Redistribution Through Public Choice*, ed. H. Hochman and G. Peterson (New York: Columbia University Press, 1974): pp. 20–42.
12. It is clear, for example, that open and free international migration would stimulate massive migration into nations even if migrants were wholly excluded from the voting franchise. It is precisely the claims that such migrants might make on the "common funds" of the community that provides one of the rational arguments against open migration. See Leland Yeager, "Immigration, Trade, and Factor Price Equalization," *Current Economic Comment* 20 (August 1958): 3–8.
13. The model here, and indeed much of the discussion in this section, is influenced by Winston Bush. See his "Individual Welfare in Anarchy," in *Explorations in the Theory of Anarchy*, ed. Gordon Tullock (Blacksburg: Center for Study of Public Choice, 1972), pp. 5–18.
14. This explanation of the apparent charitable impulses of the very rich is akin to that offered for other groups by Gordon Tullock in his paper, "The Charity of the Uncharitable," (see note 7).
15. My own recognition of the basic point that the property-rights assignment takes place when the franchise is granted was, so far as I can tell, influenced by two sources. First, the discussion of W. C. Stubblebine, in a seminar on property rights, made clear that the presence of others in the social group must modify the environment for Crusoe, and this must be taken into account in any analysis. See his "On Property Rights and Institutions," in *Explorations in the Theory of Anarchy*, ed. Gordon Tullock (Blacksburg: Center for Study of Public Choice, 1972), pp. 39–50.

    Secondly, Nicolaus Tideman, in a seminar discussion in Blacksburg, Virginia, on 19 May 1972, advanced a proposal for using posterior probabilities as a means of getting around the revelation-of-preference problem in public goods settings. In this discussion, Tideman explicitly referred to the notion that, once choice alternatives are introduced for a vote, the property rights of those who hold differing positions on the alternatives have already been modified.
16. This modification in my own position brings me close to that expressed by Musgrave in his "Comment," cited above (note 3), on the Hochman-Rodgers paper. Musgrave suggested that "primary" redistribution occurs as a result of the

''social contact'' within which political decision making takes place. He did not, however, attempt to modify the applicability of the Pareto norms. Furthermore, Musgrave's position, as expressed in his ''Comment'' seems at variance with the explicitly normative stance taken in his presentation of the three-part budget. In that part of their ''Reply'' relating to Musgrave's criticism Hochman and Rodgers also take a position similar in many respects to that developed here. However, they note at one point that ''one cannot determine in welfare terms, whether the initial or market-determined distribution of income is satisfactory *until* Pareto optimal transfers have occurred'' (p. 999). This inference is directly contrary to that which emerges from the analysis of this essay. Taking the ''property in franchise'' approach, we can say that the initial positions from which Pareto-optimal redistribution (defined in the Hochman-Rodgers sense) may take place cannot be established until the political or majoritarian redistribution has occurred.

17. In a discussion that is directly relevant to this essay, Alan T. Peacock and Charles K. Rowley criticize those who have developed models for Pareto-optimal redistribution on the grounds that the status quo starting point along with difficulties of securing unanimous agreement lend a conservative bias to the whole analysis, a bias that they consider contrary to liberal values. See ''Pareto Optimality and the Political Economy of Liberalism,'' *Journal of Political Economy* 80 (May/June 1972): 476–90. Much of their criticism of the Pareto norms vanishes, however, under the reformulation suggested in this paper.