

Achieving Political Change In the Welfare State: A Case for Moderation

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I

In this paper, I want to direct attention to three separate questions.

First, do we really want to achieve political *change*; or should we rather be seeking to suppress it?

Second, what *kinds* of changes should we be focusing on?

And third, by what *means* should we be seeking to exercise our influence?

In asking the first question, I am not asking a question about the direction in which policy should broadly move. I am rather asking a question about change itself. Should we be for or against change *as such*? I am trying to suggest a distinction (I think an important one) between what I shall call the policy radicals on the one hand and the policy conservatives on the other – between the idealists and the moderates, if you like. This radical/conservative distinction cuts across ideological divides – it is as relevant among egalitarians and utilitarians as it is among classical liberals. But it often gets overlooked – and so I want to give it special emphasis.

In posing the second question, I am hoping to make a gesture towards the “welfare state” aspects of our overall topic. Many of my libertarian friends might, I suspect, be inclined to argue that there is a fundamental inconsistency between welfare states and free markets. This is the kind of libertarian for whom ‘economic freedom’ takes precedence over political freedom and for whom the primary indicator of ‘economic freedom’ is the size of the tax take. I am inclined to think that both these properties involve a mis-identification of the true disease. I am also inclined to think that such mis-identification has costs – that because it overlooks important constraints in the overall social system it leads to less genuine freedom than might otherwise be obtained. This claim connects with the first – it bears on the distinction between ‘idealisation’ and ‘optimisation’ – between radical and conservative libertarians, if you like. Hence the *second* question.

The third question is really to press the issue of how politics (and related social processes) really work – to test the level of consensus about what the “levers” for influence in political affairs really are. I say this because most/many of us are either academics or inhabitants of “think tanks” and we are professionally pre-disposed to the notion that *ideas matter* (equal emphasis). By “mattering” here, we mean that ideas have major political consequences and that working to change prevailing ideas holds out the best prospect for improvement in the

world. In short, we tend to see the large moral stakes in terms of a battle of ... *ideas*. The CIS – that worthy organization for the promotion of free market ideas in Australia, and institutional home of Mt Pelerin President Greg Lindsey – sports as its mantra a familiar quotation from Maynard Keynes about the power of ideas. And I think they are right to do so.

But there is a puzzle here. Our increasingly standard ‘public choice’ models of the political process – the ones on which we rely to diagnose the widespread scope for political failure – do not place much emphasis on the role of ideas at all. Those models see political agents as motivated primarily by their interests – and the central theorems about political failure do not depend on agents mis-perceiving their interests. On the contrary, regulatory capture and majoritarian exploitation and global cycling and bureaucratic rent-seeking pretty much all depend on political players perceiving their individual interests all too well, and being motivated predominantly by them. How, in such models, do ideas get real purchase? Who is supposed to be influenced by them – and why?

I want to say something about all these matters in the twenty minutes or so at my disposal. By necessity the arguments will be “breezy” and rely on what might seem more like pure assertion than careful argument. But I think all my assertions can be supported either by empirical evidence or logical reasoning or both – and I hope that if you are sceptical you will grill me afterwards.

II Change vs Direction

It is perhaps natural as a first round response to any policy proposal to ask whether the policy is good or bad – whether it leads us in the right or the wrong direction. Or perhaps how can we achieve “improvement”, given our normative conceptions. And of course, that is an issue. But as we economists say, there are no free lunches and the cost of change in one direction is quite often the risk of change in another. When you embark on some “reform” exercise, you can’t avoid the risk that things won’t go your way (by which I mean to include *your conception of the “best way”*).

So consider the following mental experiment. You can initiate a policy reform process from some status quo point S. There is an equal chance that the policy reform will be in the right direction and the wrong direction. Should you initiate the process?

If your judgement of “should” is purely prudential (or, perhaps more broadly, a matter of your preference satisfaction) then the issue is merely one of your personal attitude to risk. But suppose you are interested in what you “ought to do, all things considered” and that this does not collapse to your judgement of your own interests.¹ Then the issue will be a matter of the degree of goodness of alternative states of affairs – or intrinsic rightness of alternative actions. This won’t just be a matter of risk attitudes: it will also be a matter of the relation between the domain of evaluation and value.

¹ It is of course a separate issue as to whether, once you have determined what you ought to do all things considered, you will actually *do* it. There may be competing considerations, which weigh more heavily than you think they ideally ought to weigh. But still, working out what you ought to do seems likely to exercise some influence over your actions even if it is not axiomatically decisive.

People can differ about this, even where they evaluate the outcomes entirely identically. So depict the good outcome by X and the bad outcome by N. Consider individuals A and B who by hypothesis evaluate X equally and N equally. But A evaluates S highly vis-à-vis X and B evaluates S lowly. A has a value function that is convex over the range between X and N; B has a value function that is concave. So A will think the 50/50 bet a bad one; B will think it a good one. We can describe A as a policy conservative; and B as a policy radical or idealist. For A, the important thing is to avoid the downside risk; for B the downside risk is a second-order problem: the important thing for B is moving closer to the ideal.

Suppose, now, that people differ in their ‘ideal points’. Suppose that A is a classical liberal; and D a social democrat/egalitarian. And suppose that both A and D are ‘policy conservatives’ in my sense. For them, compromise at S is to be preferred to a 50/50 chance of their respective ideals. Let A’ and D’ be the corresponding policy *idealists*. No such compromise between them is possible – both prefer the ‘reform agenda’ even though it may turn out against them, just because the *status quo* is evaluated by both to be so very mediocre compared to their respective ideals.

One way of capturing the contrast is to say that the idealists would prefer to be turn-takers than policy compromisers. Idealists have, that is, common preferences for political institutions that allow them to impose their conception of the best situation on everyone. A 50% chance of having their ideal is better than a certainty of a compromise position. The conservatives by contrast would prefer to avoid alternating extremes. Behind the veil of ignorance they would prefer institutions that encourage policy bargaining and compromise between people with different values.

I think there is much to be said for the moderate position. However, I do not seek to advance those arguments here. I will however make two observations.

The first is that the current environment is not a hospitable one for defending the free market. The common view is that the last decade has dismantled much of the regulatory apparatus that was designed to protect individuals against risky activities (in the first instance, from undertaking mortgages that they could not afford) and that the current crisis has proven once and for all that that strategy fails! Most of my mildly leftist friends are pronouncing the “end of capitalism as we know it” with both confidence and relish. And though this is a gross overstatement in my view, the current situation has certainly encouraged the view that government is “risk-bearer of last resort”; and that if you are large enough, there is a fair chance that government will bail you out from your mistakes and/or bad luck. Of course, bail out is not guaranteed. But it does not *have* to be guaranteed to create increased incentives for risk-taking and scale.

The second point is captured in the interventionist’s aphorism that “one should never let a good crisis go to waste”. One way of thinking about the force of this aphorism is in terms of the Kahnemann and Tversky prospect theory – that individuals tend to treat gains and losses asymmetrically. In particular, if a typical individual endures an unexpected loss – one that moves her away from what she has taken to be the “normal benchmark state of affairs” – she will become risk-loving in her attempts to retain that *status quo* – and specifically, risk-taking in their attitudes towards policies that offer a chance of that recovery. In a crisis, “something

has to be done!” and done even if its chances of success, more coolly assessed, are not so great! I think that in the current climate, many countries are vulnerable to this kind of experimentation – and I think it unlikely that it will be in the direction of freer markets and greater individual liberty!

So... my view is that the best strategy in the current climate is moderation. We should maintain confidence in the broad institutional structures put in place over the last fifty years. We should not necessarily lament government “stimulus packages”, because these are by their nature framed as *temporary* measures. One might well think that bail outs are broadly a bad idea: that people who made mistakes should take their medicine and that giving signals that government will intervene in situations like the current one is broadly bad policy. But *that* I believe is a counsel of perfection. What we ought to focus on is the importance of *not* running off half-cocked, engaging in large-scale nationalisation schemes or radical re-regulation. The gains that have been made over the last fifty years are significant and they are in some peril; and in that sense, the call to moderation and policy conservatism seems to me now to be the appropriate one. The downside risk is currently rather greater than the upside gain.

III Identifying the Threat

A standard conception in classical liberal circles is that the free market and the welfare state are natural enemies. This comes, I think, from a tendency to identify the extent of government intervention in economic processes by reference to the size of the fiscal take (say taxes as a share of GDP). I think that is a mistake. In fact, four claims:

1. We have no simple measures of the degree of regulatory “intervention” in market processes – and any measure would involve both conceptual and measurement problems of a high order. But I think we can all agree that we need some such measure to assess the extent to which markets are “free” in any reasonable sense – and that tax share on its own is at best only part of the whole;
2. Regulation is a policy technology that is an *alternative* to fiscal measures: if this is so, then regulation and taxation are to some extent substitutes not complements. And if this is so, then an important normative exercise is the comparison of fiscal and regulatory measures. Budgetary measures have the advantage that they are more explicit, their magnitude more readily assessed, more capable of being capped, and more contestable within the policy domain than their regulatory counterparts. [When I say “contestable” here I have in mind that aggregate budgets are often relatively fixed, so specific policy proponents within a budgetary context have an incentive to scrutinise others’ proposals: if you get up your expensive health proposal, that reduces the chances of me getting my education proposal. If policy is pursued via regulation there is no such natural competition.]
3. The evidence from the “economic freedom” literature indicates that tax share is *positively* related to GDP per head and GDP growth, not negatively. The overall negative relation between indexes of economic freedom and per capita GDP comes about by virtue of all the *other* elements in the index –

specifically *not* tax share! This is a point that our Scandinavian friends have noted though it has not been widely emphasised.²

4. There is a simple explanation for this relation. Governments with a high (marginal) tax take have an incentive to keep GDP high because GDP is a broad index of the tax base. Governments generally like more taxes, other things equal, and so a government will be more inclined to protect GDP (by say not introducing GDP-reducing regulations, tariffs etc) if its marginal stake in the GDP saved is higher. The story is doubtless more complex than this. But the bottom line is that to the extent that the alternative to higher taxes is more regulation, higher taxes may be a good thing not a bad!

These conclusions arise because I am treating policy in an optimising, not an idealising framework. Government is a fact. Policy-makers desire to “make policy”. And the best feasible arrangement will be to treat those facts as facts and optimise around them – not to pretend that the facts are other than what they are.

And while I am in the area of outrageous thoughts, let me just add the speculation that there are worse things governments can do with their revenue than to farm it out to individual citizens. In an ideal world perhaps governments would be rather less redistributive than they actually are. But in the world we face, welfare spending is not as big an enemy to free-market operations as many other things that governments can (and do) do.

IV Means

Suppose that we are decided that the chief focus of our attention should be regulation rather than taxes, and that our efforts should be aimed more at opposing dangerous policy initiatives from quasi-socialist idealists than developing grand plans for more extensive laissez-faire. There is still the question of *means*. And here, as I have noted, there is an issue of squaring our practices with our theories about how policy determination actually works.

The standard public choice view is that policy is emergent from an equilibrium process somewhat like market determination of price and quantity. Parties make bids by putting up rival policy platforms. Each individual voter supports the party that offers the best deal for herself. There will be a party that gets a more support than any other. And a policy platform will emerge. There are lots of wrinkles of course. Because the composition of the majority can change, there may be no determinate outcome. Details of voting mechanisms and aggregation processes (proportional representation versus single-member electoral districts) can vary; and the effects of institutional changes of this kind on policy can be predicted. In all this, there will be some role for political advertising, just as there is a role for advertising in markets. But ideas of a more general kind would not seem to play a special or differentially major role in this overall picture.

² See Berggren, N. (2003) “The Benefits of Economic Freedom: A Survey” *The Independent Review* VIII p193-211. Hartmut Kliemt and I make rather more of the point in “The Power to Regulate” in B. Neumärker and Claus Schnabel(ed) *Ordnungspolitik für den Öffentlichen Sektor* Metropolis Verlag, Marburg (2007) 41-62

But I think this general picture of politics as a battle of interests – and specifically of voters scrambling to promote their individual interests as best they can – is a mistaken one. I have long argued that voting is more like cheering at a football match than choosing an assets portfolio³. The argument is largely a decision-theoretic one. It depends on the disconnect between my individual vote and the outcome that emerges – voting is more like filling in a questionnaire as to what one likes than market choice. And what this means is that electoral competition is more a matter of parties and candidates presenting themselves as something to *cheer for*. And I think ideas play an independent and significant role here. People can be led to cheer for compelling ideas – ideas like freedom and general opulence (to use Adam Smith’s term) and justice and truth and goodness. In what I felt to be a striking moment in the film *Superman I*, Lois Lane asks Superman just what it is he stands for. In response, Christopher Reeve (playing Superman) gazes into the middle distance and declares, with an unaccustomed, slight but distinct shake in the voice, that he stands for “truth, justice and the American way!” And I confess that my impulse at that point was to rise out of my seat and cheer! If he had said: “Liberty, the power of exchange, and the Hayekian great society” I might just have done so.

In this sense, I think that political process is at least as much a battle of ideas as it is of parties and candidates and interests. And of course I think that within the domain of politically relevant ideas, some are better than others. Those ideas need to be articulated and explained and made salient. But as Keynes shrewdly remarked about ideas of defunct economists (he might have had Marx in mind) these ideas can take on a life of their own: they can develop a kind of power that is independent of their validity or relevance. That is why democratic political process is in part, as Hayek always insisted, an *intellectual* as well as a moral enterprise. And frankly a *rhetorical* one.

This is one point at least on which Bryan Caplan and I are broadly agreed – that ideas in the political arena become objects of *attachment* as much as they operate as units in a more generalised search for truth. People give up their political ideas only with considerable reluctance; people are resistant to evidence that runs contrary to what they like to believe. Ideas thus present themselves rather more like consumer goods than aids to clearer and more accurate thinking. So it is not enough to present the arguments and the evidence. They must be presented in a winsome way. As Jim Buchanan used to say of the teaching enterprise, quoting Herbert Spencer: “*only by varied reiteration can alien concepts be forced upon reluctant minds!*” This is, I think, a quotation as relevant for general political life as for the classroom. And it is the task to which in large measure this Society is committed.

But if this *is* the right way to see political process, then our models of political process ought to reflect that fact. I don’t think one can have it both ways. I don’t think one can hold to a view that individual interests are the central motor of individual action in politics as in markets; and also hold to the view that broad abstract theories have serious political traction!

V Conclusions

³ For example, in Brennan and Lomasky (1993) *Democracy and Decision* Cambridge: Cambridge University Press.

Take the points in inverse order:

1. We have good rational actor based reasons for thinking that “big ideas” of a broad normative kind *matter* in politics – ideas about freedom, about the public interest, about “justice”. As Gwendoline Fairfax says at a notable moment in *The Importance of Being Earnest*, “we live, Mr Worthing, in an age of ideals”! She might have been talking of politics.
2. Political power is a fact. It is not something that we can conveniently assume away. That is just wishful thinking. We need to understand how it works in order to optimise around it. “Achieving Policy Improvement within a Welfare State”, as our title has it, is a matter of doing this. That means not just accepting the things that can’t be changed; but also recognising among those things that might be changed, which takes the highest priority. I am not at all persuaded that the welfare state apparatus represents that highest priority. In many ways, some obvious some less so, the welfare state and feasible freedom are I think complementary. I have suggested one, perhaps less obvious, way in which I think that is so.
3. One of the strengths of ‘conservatism’ is precisely its pragmatism – its preparedness to recognise that life is not a choice between the absolute ideal and everything else but rather between alternatives all of which are imperfect to some extent. This pragmatism, as applied in the policy domain, has three related features:
 - a broadly optimising (as opposed to an idealist) approach;
 - a tendency for the *status quo* to have a kind of intrinsic normative magnetic force (to have a presumption against change as such);
 - a predilection towards compromise. Conservative libertarians and conservative social democrats do have something in common: they will settle on points that neither of them regard as ideal so as not to land in outcomes each regards as worse. Idealists do not have that feature.