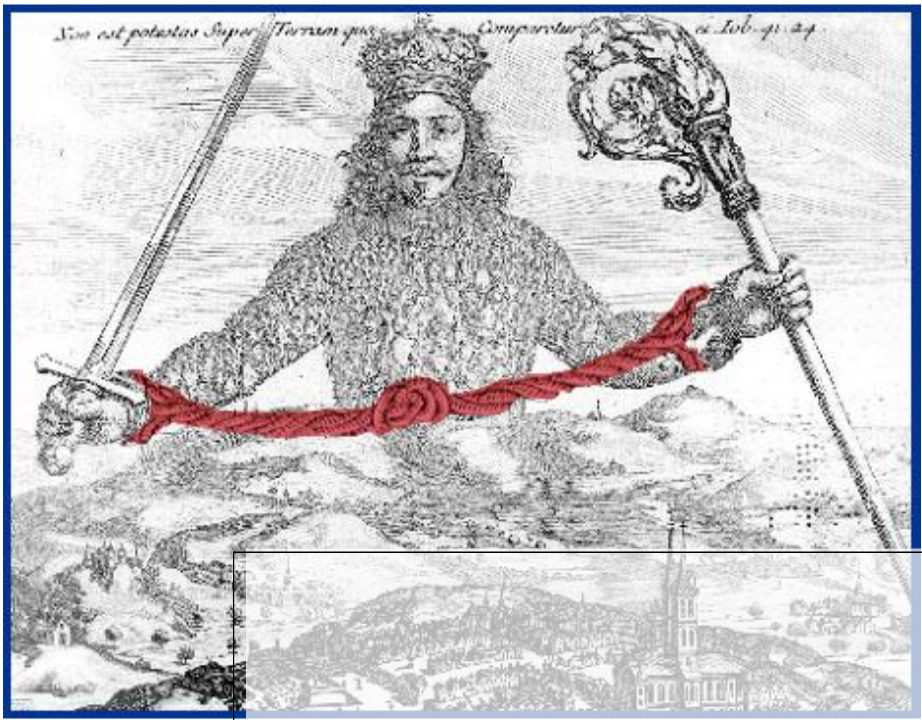

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*The Tolerance Premium as a Constitutional Element of the Protective Welfare State**

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The Tolerance Premium as a Constitutional Element of the Protective and Welfare State

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May 2011

Abstract

Indeed it is the case that "[e]very possible general answer has already been given to the question of how much should be transferred to the poor" (Olson, 1986). The underlying motive for this multiplicity of answers can mostly be located in the range of exogenously taken views on the trade-off between equity and efficiency which is supposed to arise every specific set of social policy measures. If however the welfare state is analyzed endogenously, that is from a constitutional economic standpoint, three clear-cut motives for its existence are to be evoked: the insurance motive, the self-protection motive, and the interpretation of charity as a public good. Yet, even if these motives escape the orthodox trade-off, they do not entirely embrace the reciprocal conditionality of the productive and the protective state. A remedy to this can be the tolerance premium (Homann/Pies, 1996), representing the collective measures and payments attributable to the productive state which at all enable the consent of every individual to the productive state. Traces of arrangements resembling a tolerance premium in the mentioned sense can also be found in the work of James Buchanan. They however all essentially remain trapped in an apology of the status quo and thus in practice re-enter the orthodox dualism of efficiency and equity of welfare measures. Only a thoroughly conflict-economic setup accounts for the dynamics initiated by the tolerance premium, but this at the price of overcoming Buchanan's two-stage theory: protective and productive states are so interdependent that they cannot be separated and steadily have to arise from simultaneously taken decisions. This approach in practice relates to other approaches like the "power resource theory" which interprets the welfare state as ultimately being the reflection of power relations in e.g. collective bargaining.

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1. Introduction

Observing the economic realities of his time, the Austrian-American economist Joseph Schumpeter (1962, p. 146) remarked in his main work *Capitalism, Socialism and Democracy*: "Capitalism inevitably and by virtue of the very logic of its civilization creates, educates and subsidizes a vested interest in social unrest." He attached so much importance to emerging hostility to the existing order to eventually predict the decomposition of the whole economic system.

Now, disregarding the question, whether Schumpeter was actually right or not, or may yet come to be it, his statement expresses something that economic science as a whole probably still suffers from: the lack of theories which analyze economic processes as being both dependent on the social environment within which they take place and at the same time being the basis for this environment. Or more concisely: even though there is an increasing amount of analysis into conflict, the main object of interest in economics remains trade and exchange. Yet rarely both trade and conflict were brought together in encompassing paradigms. Whether crime or revolution are considered as illegitimate acts is a minor question of context, as long as they simply take place. Much more important, and more appropriate for economists to analyze, is why and under which circumstances some individuals or economic actors take conflict (may it be thievery or revolution) into consideration or even prefer it to production and trade. Going one step further, it may reasonably be asked what should be done to diminish the attractiveness of the conflict option for the ones practicing it. Or whether it may even be possible to consistently prevent conflict in advance.

The welfare state is a field where diverging ideas have been colliding for centuries. Indeed: "Every possible general answer has already been given to the question of how much should be transferred to the poor" (Olson, 1986). It can reasonably be said that some of these answers do not reflect reality well, though. As for some economic ones, the widespread tendency to subordinate the aims of social policy measures to the means of efficiency may be a reason. In those models many social policy measures are seen as a hindrance to the free development of economic forces or even as instruments to curtail economic liberties like property rights.

Although contemporary economics disposes of a range of models which indicate economic motives for the existence of a welfare state or even justify real-world arrangements within an "orthodox" framework, the conflict-economic dimension is often entirely missing. That is to say, all welfare measures are well analyzed in detail and extent while everything else is assumed static. But an isolated examination of social policy measures, detached from an analysis of the dynamic environment where they impact, eventually degenerates into a mere thought experiment. Most economists are indeed aware of this: nowadays, for example, it is almost common sense that a poll tax should not be considered anymore, because its implementation is regarded as hardly feasible. This has been known since Thatcher (e.g. Cullis et. al., 1991). But it may be the case that such an observation just as well holds for a range of other policy recommendations. In any case, economics should not wait for reality anymore to be put right, but steadily adjust elaborated theories on its own. Probably the concept of the "tolerance

premium"[1] constitutes one appropriate tool for doing this.
The aim of this work is to introduce this concept and – contrasting it with other, long-serving models – to present an outline of its further developments and possible modifications. In the end, and coming back to Schumpeter, it is about the question of whether the "vested interest in social unrest" can be broken in the long run by an appropriately designed institutional structure. If yes, either Schumpeter was wrong or we will not be living in capitalism anymore.

This thesis is organized as follows: chapter 2 outlines the most important of the mentioned economic concepts of the welfare state and examines how these are linked to the institutions of the protective state. Starting with the classical dualism which underlies the debate between advocates of "universal" and "residual" welfare states (Wilensky/Lebeaux, 1965), we finally end up introducing the concept of the tolerance premium. In chapter 3 light is thrown on two more or less elaborate contractarian models containing the tolerance premium, namely the German *Ordnungsethik* and Buchanan's two-stage theory. What must follow at that point is a critical examination of these two concepts and their implications. This is addressed in chapter 4. The purpose of chapter 5 is then to answer how detected flaws of the former concepts could be overcome. Not surprisingly, it is conflict-economic reflections which constitute an attractive remedy. At first sight this happens at the price of posing new problems of collective organization. Yet, as it will be shown, these problems are neither uncontested nor always of much relevance. This holds as well when it is about elections – another field (and probably the most important one) where the tolerance premium is articulated and which deserves attention. Finally, we take a trip into other social sciences where several approaches which are highly relevant to the concept of the tolerance premium can be found. These help us underpinning the high relevance of the conflict-economic approach for group-based considerations. At this point, it is concluded that the tolerance premium as a procedural method – rather than a clear-cut concept – should be an indispensable part of any economic policy analysis and needs to be deepened both in theory and empirically.

2. On the economics of the welfare and protective state[2]

1 Translation by the author from the German *Duldungsprämie* (Homann/Pies, 1996). "Acceptance premium" or "quiescence premium" could be employed likewise. Nevertheless, the translation to "tolerance premium" is not only more precise, but also avoids the adoption of an already known expression in insurance mathematics (acceptance premium) which denotes not at all the same concept. The tolerance premium itself is introduced in chapter 3.1

2 In the context of this work, the welfare state will mainly be analyzed within the contractarian framework. This excludes a range of theories as well attributed to the welfare state and mostly belonging to the field of welfare economics, in particular the theory of market failure (e.g. Mankiw, 1998). This function will partly be addressed for public goods below, but evidently it is consulted for a whole range of phenomena from merit goods over externalities to informational problems. The theory of market failure, however, aims to resolve the considered trade-off in-period, and most vigorously by means of the benevolent planner. Hence, as it will be shown, it does not offer a way towards endogenous models of the protective and welfare state and was mentioned here only for the sake of completeness.

2.1 Orthodox dualism

Traditional public finance generally identifies a trade-off between its two main objects of interest, the allocation and distribution of resources and production. The so-called *equality-efficiency trade-off* (e.g. Browning/Johnson, 1984) describes the widely accepted dilemma of the social planner who must choose either an efficient and productive economy with an income distribution most likely to be very skewed, or a more equal distribution inducing an unproductive economy.[3]
The dilemma comes down to the famous metaphor that the size of the cake depends on its division. Equality, on the one hand, could be defined as the uniformity of income or wealth distribution and is measured for example by the "Gini-coefficient" (Gini, 1912). Efficiency, on the other hand, is often virtually regarded as a synonym for the free-market allocation – probably corrected for technical market failure, but not accompanied by intrinsically redistributive measures – and assumed to achieve maximum welfare in the aggregate.
The standard explanation of the equality-efficiency trade-off is delivered by Okun (1975, p. 91) who states that with transfers of money from the rich to the poor, "some of it will simply disappear in transit". He calls this phenomenon a "leaky bucket" (ibid.) and identifies four reasons for its existence: administrative costs of the government, altered work incentives caused by taxes and transfers, distortions of saving and investment and changes in risk attitudes induced by a dampened "rags-to-riches dream".
Following Okun, Baldassarri/Piga (1996, p. 258) distinguish between an internal and external evaluation of welfare state efficiency. By internal evaluation they describe the efficiency "by which the welfare state is managed", on its part not affecting the external question of whether it is "useful and/or opportune to have an efficiently managed welfare state". We henceforth focus on the external term, as in the context of this work this raises more fundamental issues. Internal efficiency, in turn, maps out a classical field of positive public choice theory.
Nevertheless, Okun does not even attempt to measure the leakage. But he invites the readers to think about their own preference for a maximally acceptable leakage in a particular example. Personally he would "stop at a leakage of 60 percent" (Okun, 1975, p. 94). This procedure brings us straight to the point that ultimately the decision between the desired degrees of equality and efficiency can be nothing but a normative and exogenous one, at least in the traditional framework. The instrument in welfare economics which best pins down the normativity and exogeneity of the trade-off is the social welfare function, briefly discussed in the appendix.
Generalizing the equality-efficiency trade-off, Homann/Pies (1996, p. 206 ff.) speak of a

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3 Quite often this is also called the "equity-efficiency trade-off" (e.g. Keenan/Rubin, 1985). This is erroneous insofar as equity does refer to some notion of structural fairness, and not to the uniformity of income distribution. Keenan/Rubin (ibid., p. 429) alternatively distinguish between two different definitions of equity used in the literature: equity in an egalitarian sense – that is equality – and equity in a Rawlsian sense following the maximin principle. Whereas the former enters the trade-off, the latter is completely compatible with the Pareto criterion, that is efficiency.
To illustrate the compatibility of equity and efficiency, Worland (1986, p. 65) resorts to simple neoclassical causalities: if employees (and other "production factors") are paid their marginal product – which perfectly satisfies pure equity – prices equal marginal costs in all markets and efficient (perfect) competition is attained.

dualistic conception which characterizes the traditional theory of social policy as describing an antagonism between social and economic dimensions, respectively between equality and liberty[4]. They refer to Lampert (1990, p. 61) who states that at a specific level of redistribution the relation of liberty and justice becomes a negative one. Within this relation, the advocates of social policy on the one hand see in redistribution the necessary instrument to restore a normatively desired income distribution, even for the price of curtailing economic liberty. On the other hand, its opponents see in social policy *per se* the deformation of market economies.
Homann (2003) established a classification of social policy conceptions, denoting the above mentioned positions a *social policy through,* respectively *against the market*. Whereas the latter conception sees an extended welfare state as an indispensable corrective to the market forces, assumed unable to foster "social justice", the former likewise embraces a dualistic view by simply negating the need for any social market corrective.
Blümle/Goldschmidt (2004) date the "orthodox dualism" back to a misperception of Adam Smith who was erroneously interpreted to have identified the presence of two different human natures in his main works *The Theory of Moral Sentiments* (1759) and *The Wealth of Nations* (1776). While the latter established the economic motivation of the human, incarnated by *homo economicus*, the former work has often been regarded as opposing this view by appealing to sympathy as the main moral motivation of humans. Goldschmidt/Blümle attest the compatibility of those two motivations which are both present in reality, but merely in two different spheres of action. According to the authors, the alleged divergence of human nature in Smith is wrong and gave rise to the still present "deceptive dualism of ethics and economics" (ibid., p. 181).
Now, there are several concepts of the welfare state which are in fact not entirely capable of overcoming the orthodox dualism, but certainly the exogeneity of distributional norms. Let us first turn to these in the next three paragraphs before deepening the fundamental criticism of the dualistic concept and trying to overcome it further.

2.2 The insurance motive

In order to find endogenously legitimated motives for welfare state arrangements, obviously the exogenous norms of welfare economics need to be abandoned. As a consequence, even the social planner, applying those norms at his own discretion, cannot survive in an endogenously built framework like the contractarian two-stage theory of Buchanan (and others). The latter is

4 Reasonably, this antagonism can only be claimed to arise within a specific interpretation of liberty, namely the hypothesis that the mere absence of formal restrictions imposed on individuals is really perceived as liberating and does not itself operate as a possible restriction for some. But the concept of liberty was always contended. Berlin (1958), for example, distinguishes between "negative" and "positive liberties". Whereas the former describe the absence of constraints imposed by others (e.g. the protection of property rights), the latter characterize the absence of social constraints like poverty. Positive liberties thus initially enable the individuals to actually be in a position where to benefit from negative liberties. By integrating them into the analysis, one might thus as well arrive at a situation of complementarity of equality and liberty. Even though these reflections should strongly be extended, this cannot be done here for the sake of conciseness.

briefly introduced in the following paragraph:
In *The Reason of Rules*, Buchanan and Brennan state that "justice takes its meaning from the rules of social order within which notions of justice are to be applied. [...] Talk of justice without reference to those rules is meaningless" (Brennan/Buchanan, 1985, p. 97). They normatively argue that rules are "logically prior" to justice as they form the foundation upon which a specific distributional outcome is achieved. Such an outcome would be a just one, as long as the "rules of the game" are uphold during the game. Those who enter it do so because they understand and accept the rules, at least tacitly. Justice is therefore defined "in terms of conduct that does not violate agreed-on rules" (ibid., p. 110), and it is reached "as an intrinsic part of the relevant rule structure", not as an externally imposed norm. These arguments lead Buchanan, following Wicksell (1896), to propose unanimous agreement to a rule structure on a constitutional stage as the only viable form of (pareto-)efficiency and eventually justice. Behind a "veil of uncertainty" (Buchanan/Tullock, 1962), which impedes the individuals from deciding in possession of individualized knowledge about their future, anarchy is thus overcome collectively and in the interest of all participants. A rule structure is established where postconstitutional trade as well as the collective provision of public goods within the defined limits of a productive state can take place.
These remarks suffice to introduce the first common reason for public welfare provision which can be assigned to the contractarian field: the insurance motive (Brennan, 1973). Its essence is that in the presence of high uncertainty individuals are ignorant of their future income positions and may thus fear low income levels or future income reductions. Making the common assumption of risk aversion, this can be paraphrased by the following quotation (Olson, 1986, p. 197): "The money we receive if our house burns down means more to us than money does when we have not had any such misfortune". Obviously, this thought is well transferable to social insurance. The gain from transfers on a low income level is much more precious in utility terms than an equal loss in the form of taxes or insurance premiums on a high income level, if we assume diminishing marginal utility (implying a concave utility function and thus risk aversion). Having no individualized knowledge, i.e. being unable to know whether to belong to the transfer receivers or not, individuals could thus agree on insuring their future income. In addition to the prevention of bad luck, the simple desire to smooth out marginal utilities over a life cycle with forseeably productive and unproductive phases is an argument for insurance schemes as e.g. retirement provision. Total utility would surely be increased by "some means of 'exchange through time'" (Buchanan/Tullock, 1962, p. 193).
In this view, public welfare provision takes the form of redistribution ex post, i.e. on the postconstitutional stage, but is established as insurance ex ante, on the constitutional stage. However, this consideration does not imply that redistribution is in the interest of everyone at the time it takes place, but well at the time it is approved behind the veil.
The veil of uncertainty is a crucial assumption for the insurance motive and therefore needs some examination. Remaining on an abstract level, Buchanan simply assumes that the veil is "sufficiently thick" (Buchanan, 1987, p. 249). Even though this can fundamentally be questioned,

the maintenance of a sufficiently high level of uncertainty is exploitable for example by assuming sufficiently long time periods on the basis of which decisions are made. With a perspective long enough to make income unpredictable – Sinn (1997) suggests 40 years – factual uncertainty is established. This will likewise be the case if we assume deciding parents to be interested in securing the income of their descendants and thus extend the considered period up to infinity. Taking sufficient uncertainty as given, it is not yet obvious why under the assumptions made private insurance could not equally carry out the function of the redistributive agency. With the independence of risk, the absence of adverse selection and the prevention of moral hazard, three conditions need to be met for realizing an insurance market (Märkt, 2002, p. 5). The first condition is most probably tantamount to whether the labor market as a whole is balanced in the long run (if it is not, no private company will dare to offer social insurance). The remaining conditions require the absence of asymmetric information, a topic which is not deepened here. Whereas private insurance could indeed overcome moral hazard by claiming co-payments of the insured (even though that reduces coverage), the remedy to adverse selection is to declare insurance compulsory in order to retain the good risks (probably the rich) in the insurance pool (ibid., p. 7). But this virtually equals a publicization of the insurance market.

Moreover, as stated by Brennan, in practice there is a range of contingencies which are "pretty well completely uninsurable privately", for example nuclear war, domestic revolutions or hyper-inflation (Brennan 1973, p. 52). It is obviously not the case that such events would not pose any problems for public insurance. But at least its superiority, resting on economies of scale and risk pooling, can be maintained without doubt (ibid.). Buchanan/Tullock (1962, p. 193) also remark that an individual "may be more willing to accept the cost of such an uninsurability if he knows that all members of the group are to be included in the plan", that is in the presence of public insurance. Nevertheless, it is doubtful at this point whether public provision that may step in can still be called an insurance: after all, insurance is always "expectation-preserving" (Goodin, 1988, p. 159). But this premise does not hold when risks are dependent, which is the case for example in a long-lasting crisis hurting all economic sectors. Therefore additional redistributive elements for reaching a balanced funding are required. Or in other words: In case of massive economic downturns, social insurances have to be bailed out with additional funding by the state which is the only remaining reinsurance agent.

To conclude, in Brennan's view the insurance motive on its own gives no justification for pareto-efficient postconstitutional redistribution (Brennan, 1973, p. 54). But pareto-efficiency can still be reached, he argues, thanks to several by-products of social insurances. These could be their effects to reduce the probability or intensity of misfortune (the "natural stabilizer" function of unemployment insurance is exemplary) or philanthropic actions on the part of the potentially rich. In the following section we will turn to the possibility of altruism as a motive for redistribution.

2.3 Charity as a public good

A common motivation for public welfare provision is indeed the sympathy for others. The welfare state could simply be seen as a universal social safety net, indispensable for the common weal by securing a worthy income level in case of individual misfortunes. Constitutionalists deny the possibility that individuals systematically strive for the public good when they make decisions, but nevertheless "other-regardingness" can be incorporated without problems into the contractarian framework (Brennan/Buchanan, 1985, p. 37). Yet again this should be in the form of constitutionally expressed preferences giving rise to generally applicable rules.
On the basis of Friedman's charity dilemma this point can be made clear (Friedman, 1962, p. 91): "I am distressed by the sight of poverty; I am benefited by its alleviation; but I am benefited equally whether I or someone else pays for its alleviation. [...] we might all of us be willing to contribute to the relief of poverty, provided everyone else did." This quote obviously describes the common problem of the underprovision of public goods, in this case charity. Every altruist has an incentive to free-ride on the others' donations, none will end up donating, and nevertheless everybody regrets the outcome (Goodin, 1988, p. 156). Given this collective action problem, only the public provision of charity can cover the privately desired amount of this "good" and satisfy the altruism levels of the individuals. These arguments are apparantly not so intuitive to a range of economists who still cry for welfare state retrenchment mainly in order to make the thereby gained amounts available to the alleged eagerness of a significant group to donate (see e.g. Tanner, 1996).
It is important to note that the above adopted form of altruism can be expressed in a simple utility interdependence framework (Feist, 2000, p. 14). Within this, the utility function of an individual depends not only on his own income, but also on a factor of all the other individuals' utility (mainly composed by the transfers received, in case of the poor[5]). These utility interdependencies could not only account for, but might even require redistribution for achieving ordinary pareto-optimal allocations, as Hochman/Rodgers (1969) show. Within this not too benevolent definition of altruism it is of no relevance for a rich individual whether the alleviation of poverty is achieved by himself or by somebody else. Otherwise – that is in the presence of a "warm glow effect" (Andreoni, 1990) – there would be no collective action problem. But given this, philanthropy may just as well coincide with self-interest, because the suggested utility interdependence as well expresses the risk of an individual's utility to shrink if the respective levels of others are neglected (Feist, 2000, p. 14). This applies ever more the richer the individual is, if we again assume diminishing marginal utility. As a consequence, the public good would not be charity, but the prevention of poverty externalities – intrinsically arising a protective and certainly not a charitable motivation. This issue is deepened further below, but it should already be mentioned here that its contractarian analysis will not be so straightforward, because the

5 Possible utility interdependencies among the rich can actually be neglected if we make the following reasonable assumptions: i) the number of the rich is very small relative to the total collectivity; ii) utility functions display diminishing marginal returns (i.e. the utility change of an income adjustment is the bigger the poorer the individual).

assumed version of altruism has different consequences for productive and unproductive or even disabled individuals.

Hence we see: as soon as it is considered within a broader context, the concept of charity as a public good might erode as an endogenous reason for the existence of the welfare state – just as the insurance motive does. It is high time therefore to integrate protective considerations into the analysis, for without these a full understanding of the welfare state cannot be reached.

2.4 The self-protection motive

The assertion of Brennan's (1973) self-protection motive is straightforward: large income inequalities are the foundation of "potential political explosiveness", and redistribution one means of their removal. This is in the interest of all those fearing political upheaval on material grounds, i.e. having reasons for protecting their property rights. Brennan's self-protection motive assumes a preventive character insofar as not political reaction to already caused unrest is considered, but the reaction to its threat. More precisely, he proposes three strategies to prevent a popular revolution (in the sense of a change of the ruling class) from occurring:

(1) appeasement policies – i.e. welfare measures, designed to increase the "opportunity cost of revolutionary activity";

(2) repression policies – measures to reduce the probability of success of a probable revolution;

(3) threat policies – the increase of the revolutionaries' predicted losses in case of a failed revolution (ibid., p. 59).

Even though for our purpose we are most interested in "appeasement policies", the awareness about alternatives which may well be present in the form of "repression" or "threat" is crucial.

Now, Brennan shows that welfare provision usually is the most effective of the three policies (ibid., p. 63). However, not in the form of raising the income level of potential revolutionaries, but by the establishment of schemes "based on the notion of equality of opportunity" (ibid., p. 60). By this, he perceives institutions which principally guarantee the prospect of a small chance to win a big prize to everybody (i.e. being lucky in the income lottery if the opportunity is seized). This would please the potential revolutionary most, as he is assumed to be most likely risk-loving and not even necessarily poor. These are certainly possible but doubtfully the most widespread attributes for the ones resorting to the option of political unrest. If consistently risk aversion is assumed again, it might easily be the case that the formal provision of equal chances does not suffice to foster protection. Nevertheless, it is not so much the findings of the model above which are most relevant in the context of this work, but the question of whether the "self-protection motive" can actually account for what is missing to fill the gaps posed by the insurance motive and the charity argument. This seems to be the case only partially.

For Brennan, the self-protection motive is the necessary supplement to the insurance motive in the case of misfortunes "explicitly associated with the redistributive process" (ibid., p. 55) and thus not expressible with the insurance motive. He uses the self-protection motive to justify transfers necessary for efficiency, disregarding the distribution of the gains from trade. But, first, due to the absence of any constitutional reference, this explanation could as well be an attempt to resolve the equality-efficiency trade-off in-period. Second, by specifying equality in the form of equal chances, that is equity, the trade-off is probably not even present as it was shown in footnote 3. In any case, the proposition of an institutional design of the self-protection motive in the simple form of equality of opportunity can hardly account for universal redistribution from the rich to the poor as it takes place in reality. Moreover, the distribution of the gains from trade really matters postconstitutionally, and successful preventive protection needs to account for this.

It is, however, only consequent that Brennan's model rests on a cost-benefit analysis and not on the public good aspect of revolution (ibid., p. 56). This avoids to again fall back into the same problems which altruism poses for the charity argument. After all, it is also the aim of the author to "[free] the possibility of pareto desirable redistribution from the need to assume universal philanthropy on the part of the rich [...]" (ibid., p. 66).

The introduction of a protective element for redistribution is indispensable and distinguishes Brennan's self-protection model from the other common motives of the welfare state. A protective motive is needed in principle, because the traditional social policy paradigms indeed do not give a satisfying answer to why the rich should "play the game". At the latest when the income distribution is revealed, the lucky ones would have no motive but a protective one, to not immediately revoke the agreed-on constitution. However, a comprehensive and endogenous protective motive cannot be established *ad hoc* on the basis of a status quo distribution. What would be of more help is a constitutional analysis of the interactions of the welfare and the protective state, as it is suggested in the title of this work. The linking element of these "two states" can be the *tolerance premium* which likewise overcomes the dualistic dilemma and to which we finally turn in the next chapter.

3. Contractarian approaches to the tolerance premium

3.1 Social policy "for the market"

The term of the *tolerance premium* (see footnote 1) traces back to the German "Ordnungsethik" of Karl Homann and specifically to an article of Homann/Pies (1996). The authors base their reflections on Buchanan's constitutional-economic framework to which we again turn in the next section and whose more dispersed references to the topic leave room for additional interpretation.

The Hobbesian state of nature is the obvious point of departure for the analysis of the tolerance premium by Homann/Pies. Anarchy is painful and can collectively be overcome first by the establishment of a protective state, which ensures property rights, and thereafter by a productive state which organizes the postconstitutional provision of public goods. It is here that Homann/Pies begin, by stating that the "privateness of goods" is a public good in itself and can thus likewise not be provided on the market (ibid., p. 222). Given that in anarchy property rights are obviously underprovided – they are not present at all – this classification is very plausible. Productive and protective state thereby move closer together: even though they perform different functions, the two states both yield gains from trade through the provision of public goods. Pies talks of a "harmonization of the protective and welfare state" (Pies, 2000, p. 125, t.b.a.) in the sense that both aim to overcome social dilemmas. It would then only be consequent to interpret the activities of the protective state as being directly attached to the productive state, like Neumärker (1995, p. 88) does.

Homann/Pies (1996, p. 214) talk of a "systematic interdependence" of the two states insofar as the protective state's legitimation depends on the expectations about the postconstitutional extent of the productive state. Even though the process still runs through two phases, social decisions are made about the "totality of the institutional structure" (ibid., p. 215) at the same time. If we resort to the above described self-protection motive, this interdependence seems plausible: behind the veil, even very optimistic individuals will consent to the possibility of postconstitutional transfers to an extent which they predict to be to their advantage. They do so not only because they wish their property rights to be secured, but these are secured only because the consent to the transfers is made.[6] In other words: "The threat potential of the poor directly links the productive state, which provides transfers, to the protective state, which ensures property rights" (Feist, 2000, p. 20, translation by the author[7]).

Referring to the notation of Hayek, Homann/Pies (1996, p. 219) then ask under which conditions rational individuals would accept the uncertainties and inequalities of the "cosmos", that is a spontaneous market order. Not astonishingly, they mention individual participation at the gains from trade (achieved relative to the "taxis", a planned order) as the fundamental condition besides the rule of law. The former is indispensable to prevent the use of veto votes which every individual is entitled to in a setting that requires unanimous agreement. The *tolerance premium* represents then exactly the collective measures and payments attributable to the productive state which at all enable the consent of every individual ex ante. Even though they indicate insurance benefits and a progressive income tax (ibid., p. 219 f.), the authors remain ambiguous about the measures which could be subsumed within their concept of tolerance premium.[8] To get the legitimation of the cosmos secured, the authors extend the tolerance

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6 Märkt speaks of "multilateral poverty externalities" which have to be contained (Märkt, 2002, p. 9). He lists delinquency and social unrest, but also the spreading of infectious diseases due to insufficient health care and the harassment by beggars and homeless. A formal prohibition to "cause" such externalities is of absolutely no relevance. When it comes to compliance, very soon a point may be reached where intensified protective measures are much less effective than the introduction of transfer payments.

7 Henceforth t.b.a.

8 A modified version of the tolerance premium is presented by Kliemt (1993) who speaks of a "social dividend": the public enforcement of rights gives rise to a "social rent" which needs to be distributed "fairly among citizens who

premium by what they call a "collective investment aid" (ibid., p. 221). This stands for measures which enrich the risk containment of the tolerance premium by giving prospects of success to the "beneficiaries", e.g. through publicly (co-)financed education. The investment aid is meant to motivate beneficiaries to actively participate in the market and not only to abstain from undermining it.

Now, because the collective decisions are made simultaneously about the totality of the institutional structure, also an assessment of the established system has to include the whole structure. Seen this way, redistribution is actually a "postconstitutional reward" for a "constitutional concession" (ibid., p. 223, t.b.a.). It can only exist independently if this relation is negated – a view which is fundamentally adopted by natural law theorists as Locke or, cited by the authors, Nozick (ibid.). These contractarians derive the legitimation of the social contract from the natural distribution of endowments. But Nozick's view that "[...] any more extensive state [relative to the minimal state 'limited to the narrow functions of protection', n.b.a.] will violate persons' rights not to be forced to do certain things" (Nozick, 1974, p. ix) is obviously not substantial in the light of the tolerance premium. It is evident that most minimal state advocates remain unreasonable in their assumption that negative rights are "simply there" instead of being socially produced (Kliemt, 1993, p. 161), respectively in their claim that every kind of welfare state necessarily violates the rule of law.

In the presented framework redistribution does not even exist as such, for it is transformed to an integral and indispensable part of the "mutual gains from trade" (Homann, 2003, p. 113). It seems obvious that this view also renders obsolete the in-period dispute about efficiency and equality, that is the above described dualistic antagonism. An exclusively postconstitutional consideration of redistribution would then analytically be inconsistent.

The authors assign the tolerance premium to what they call a "social policy for the market" (ibid.). This approach rests not only on the tolerance premium and the collective investment aids, but also on the insurance motive (Homann, 2003, p. 112). Reform discussions are aimed to be led not about extending or retrenching the welfare state, but merely about increasing its efficiency, respectively its alleged constitutional acceptability. From this, Homann/Pies directly deduce the claim for a "productive" social policy as opposed to a "redistributive" one (Homann/Pies, 1996, p. 223). Regarding social insurances, they indirectly propose a privatization on the grounds of new developments that allegedly allow for the private management of moral hazard and adverse selection problems (ibid., p. 226). Generally, the conclusions quite resemble the ones of Brennan, proposing a welfare state based on the notion of equality of opportunity. What is explicitly left out in both approaches is the possible existence of universal transfer schemes.

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participated in its creation" (p. 167). This institution would then be called the "social dividend". Kliemt suggests its precise form as an earmarked income tax of an equal percentage equally distributed among all citizens. This simple model is proposed for convincing the advocates of a "minimal state" to approve at least a "minimum welfare state", as the claim for an equal share of the social dividend complies with the characteristics of all the elements incorporated in the minimal state. The social dividend is paid to everybody and therefore comes very close to what is often called the "unconditional basic income". The model is differing from the tolerance premium presented in this work insofar as the crucial element of the latter is eventually the interdependence and interaction of its payers on the one and its beneficiaries on the other hand.

The legitimacy of these recommendations on the basis of the delivered institutional analysis can indeed be questioned, and this will be done in chapter 4. But before that, the roots of the above presented tolerance premium are examined in the following section. They are to be found in the work of Buchanan.

3.2 Buchanan's extended two-stage theory

As exposed above, any tolerance premium approach is incompatible with a strict separation of the protective and productive state. At first sight, therefore, the attempt to underpin this concept with the theories of the one who actually brought this duality forward seems pointless. The de-composition of confusions that were brought about by the failure to distinguish between the two roles of the state – particularly in welfare economics – is the accomplishment which Buchanan claims for his work[9]. Yet, nevertheless the two roles are seen in relation to each other. This is given by the very fact that the productive state must both chronologically and politically be erected on the foundation of the protective state. And for the latter, as shown above, collective action problems very similar to the provision of public goods may arise. Buchanan therefore recognizes that "law in itself is a public good" (Buchanan, 1975, p. ix), and even that "the collective provision of order is productive" (Buchanan, 1984, p. 105). Thereof he deduces that the poor do not claim their share in the economic gains from trade on the grounds of any ethical norm, but rather through their membership in an organized collectivity (Buchanan, 1975, p. 73). At the latest when it comes to unanimous agreement on the constitutional stage, such claims have to be considered by everyone, they will set the range of "necessary side conditions" (Buchanan, 1962, p. 247).

There is no doubt about Buchanan's personal view on the welfare state. He "[does not] like it, either for reasons of private interest (I am a net loser), or of ideological commitment (I do not like collectivized pension schemes)" (Buchanan, 1986, p. 179). Nevertheless, ostensibly he is not interested in transforming personal views into policy recommendations – something which would have to be done by means of some social welfare function – but to seek these latter on the grounds of constitutional efficiency, that is the (potential) unanimity for decisions over the constitutional set of rules. His test of constitutional efficiency therefore states that every presumed non-optimality of rules which fail to be changed through agreement among all individuals has to be refuted (Buchanan, 1962, p. 353). By this, it is basically stipulated that everything could rightly emerge out of the social contract, also the tolerance premium.

The next step is to consider some specific forms of what Buchanan calls the "necessary side conditions" as these may well resemble the tolerance premium. One element, which could be called a *preconstitutional transfer,* particularly sticks out: disregarding the specificities of the veil

9 Three of Buchanan's books arose from the collaboration with two fellows: *The Calculus of Consent* (1962) with G. Tullock; *The Power to Tax* (1980) and *The Reason of Rules* (1985) with G. Brennan (lead author). Talking about "Buchanan's" work, the merits of these scholars is implicitly included.

of uncertainty, it has to be asked under which circumstances a constitutional assembly could actually take place. If existing inequalities in anarchy were so high that for some individuals the mere prospect of the "rule of law" is relatively unattractive, something would have to happen before constitutional negotiations can take place. Buchanan therefore proposes a preconstitutional redistribution of goods or endowments for establishing "a sufficiently acceptable base for property claims" (Buchanan, 1975, p. 64). The tolerance premium would then be the first issue to be settled collectively, even prior to the decision over the protective state. It explicitly assumes a material character, and this in contrast to Homann/Pies who do not necessarily require the tolerance premium to be composed of a material and redistributive element. Yet again, such transfers are not to be attributed to redistribution in its literal sense, because on a (pre-)constitutional stage they are the counterpart for the establishment of a consensus which just enables the settlement of an initial distribution.

What is generally of most interest in Buchanan's work is the question of how to hypothetically constrain the Hobbesian "Leviathan" – the self-interested and voracious government. Depending on the assumptions of who could actually incorporate the latter, reflections about this issue may likewise help to underpin the tolerance premium. Brennan/Buchanan (1980, p. 28) for example propose constitutional constraints for fixing the direction of transfer flows; payments could be restricted in particular to those members of the community who qualify on the basis of individual income. This proposition could be interpreted in the sense that the rich, potentially embodying Leviathan, are deprived of the option to exploit the poor by means of the transfer system. Exploitation of the poor could be seen as a consequence of a collective action problem among the individuals composing the ruling group: it is profitable for the ruling group itself, but it jeopardizes the social order in the long run. Restrictions regarding the direction of the transfers could then serve for stabilizing the institutional structure. In general, however, the measures proposed to restrict Leviathan's "fiscal appetite", e.g. the introduction of uniform taxes to prevent the revenue-gathering possibilities of a differentiated tax system (ibid., 1980, p. 156 f.), are rather inconsistent with the requirements of the tolerance premium.

Even though the possibility of postconstitutional redistribution is often seen critically by Buchanan, some redistributive aspects are tackled in *The Power to Tax* (1980). For instance, according to the authors, under some conditions the presence of equally distributed public goods can give rise to moderate redistribution – not only towards Leviathan but also towards the poor. This could namely be the case if "uniformity on the tax side is interpreted to require anything other than equal absolute amounts of tax per taxpayer" (ibid., p. 162 f.). Such an interpretation very much resembles Kliemt's social dividend model (see footnote 8). Alternatively, in *The Limits of Liberty* (1975, p. 71) Buchanan proposes a specification for public goods to be financed by progressive income taxes. If thus all individuals who potentially prefer to live in anarchy either have demands for public goods above average or income expectations below average, a unanimously acceptable contract can be reached.

An additional and very different perspective was offered earlier in *Public Finance in Democratic Process* (1967): Buchanan here refers to Puviani's *fiscal illusions*, which is an expression for all attempts on the part of the government to give the individuals the impression of taxes being less burdensome and public provisions more valuable than they actually are (Buchanan, 1967, p. 130). A simple case would be the value added tax, which is implicitly hidden behind the price of the private goods. Another, less obvious case seems particularly relevant in the context of the tolerance premium: the shifts in public attitudes on social issues (ibid., p. 134 f.). Facing an increased fear of unrest, wherever this may come from, taxes used for redistributive programs towards the poor are more readily accepted by the rich (the "ruling class" in this model). The costs of the additional taxes are valued less given the higher opportunity costs of the status quo. This is an "illusion" in pure fiscal terms, but could overall simply be the consequence of a rising tolerance premium. Buchanan addresses the fiscal illusions even though he perceives them being based on a ruling-class model "akin to the Marxian conception" (ibid., p. 129). It is then not surprising that he does not get much out of this concept by claiming that the fiscal illusions could arise only in a nondemocratic framework based on the assumption of a both benevolent and powerful despot (ibid. p. 138). The question of how such a simple conclusion can be drawn from a more group-based approach, and an examination of what this implies for the tolerance premium, will implicitly be a recurrent subject in the next chapters.

Altogether, the elements in Buchanan's work attributable to the tolerance premium leave a wide margin of interpretation and cannot be brought together in one consistent model. What is more, the fact that Buchanan revised some ideas over his career additionally complicates the analysis[10]. Despite or because of this, a critical examination has to follow.

But before, we briefly return to Homann and Pies for whom the two-stage theory served as a basis. These authors, however, do not see their model as a simple interpretation of Buchanan's reflections, but allegedly as a more consistent version and extension of it. This view is present in a classification of Homann (2003, p. 114) where the tolerance premium is indeed attributed to Buchanan – which can be contended, as we saw – and what Homann calls the social policy *prior to* the market. Their own paradigm of the social policy *for* the market comprises not only the tolerance premium, but also an investment aid and the insurance motive, as was shown above. This classification seems a bit pretentious, though, because given the loose way by which Homann/Pies interpret Buchanan, there is no reason for not attributing to him at least the insurance motive[11] as well.

10 For example, the claim that "the collective provision of order is productive" (Buchanan, 1984, p. 105) was made in 1984 in *The ethical limits of taxation.* After all, this was when 22 years had passed since the publication of *The Calculus of Consent* in 1962. Even though similar ideas can be found repeatedly in different contributions, the attempt to construct a uniform picture out of these is sometimes problematic – at least for what concerns the arguments relevant to our topic.

11 See e.g. Buchanan/Tullock (1962, p. 192 ff.) where exactly this is outlined.

4. Critical examination of the contractarian view

4.1 The problem of the starting point

Altogether, within economics, the contractarian tolerance premium is one of the few developed theories which aims to resolve the equality-efficiency trade-off. Beyond the presented findings which this approach brought about, there are not only questions left to be answered but as well several inconsistencies to be discussed (this will be done simultaneously for the two sources exposed). The one to start with is the environment in which constitutional interactions actually take place.

We recall that even though he was aware of the interdependence of the two stages, Buchanan's theory – by the very fact of distinguishing between the protective and the productive state – lacks an important ingredient for a coherent tolerance premium. The proposition for a preconstitutional transfer is a very logical, though in itself questionable expression of this fact. In order to credibly maintain the separation of the protective and productive stage, Buchanan thereby introduces a third stage only for the negotiation over the preconstitutional unilateral transfer (see section 3.2). However, neither does this third stage play any role in subsequent reflections, nor does it really shed light on the postconstitutional stability of a protective arrangement. Indeed, it seems quite impossible that this "one-time-only, once-and-for-all rectification" (Vanberg, 2004), which is settled two steps before the postconstitutional stage, provides much stability.

As for the separation of the two stages, the assumption of individual inequalities in the natural state – explicitly made in *The Limits of Liberty*, as opposed to *The Calculus of Consent* (Buchanan, 1975, p. 70 f.) – has far reaching consequences. First of all, postconstitutional inequality must be predicted roughly to the extent that differences in the natural state exist (ibid., p. 25). Because within the two-stage model there is no mechanism that necessarily touches the present ownership relations, respectively the distribution of endowments taken over from anarchy. Even though the potentially rich are quite easily identifiable, the need on their part for a productive concession in return for the established protection is disregarded. The protective state is thus erected without considering its productive aspects, that is the public-good character of property rights. But this will only make sense if inequalities on the natural state are taken for granted and expected to be accepted by everyone in the long run. Given this, it somehow astonishes that Homann/Pies base their tolerance premium on Buchanan's theory. Indeed, they partly concede this flaw by stating that the methodical separation of the protective and productive state, and even more the primacy of the productive state, would only make sense in a natural rights paradigm (Homann/Pies, 1996, p. 224). But the allowance for natural rights to property is a relapse into supraindividual and external welfare norms, and eventually ends up in Nozick's minimal state. The basis of the tolerance premium, however, is that the stability of every structure of rights is conditioned by the distribution of the gains from trade made relative to the natural state. And if any change of the initial distribution is excluded by definition, as it is the case in a Lockean or Nozickian paradigm, there will not be much reason to expect the existing structure to become stable. Rather anarchy can be expected to remain stable. Or, as Kliemt puts it: "Natural law and natural rights do exist as real world forces only insofar as they are put into force by real world individuals" (Kliemt, 1993, p. 161).

With the veil of uncertainty there is however an important variable which influences the extent by which inequalities on the natural state are reflected postconstitutionally. Whether or not remains of natural law are a hindrance to the development of an approach to the tolerance premium, Buchanan simply assumes the veil to be sufficiently thick, as remarked above. This assumption, even though falling from heaven, would indeed "allow for some in-period fiscal transfers" (Buchanan, 1987, p. 249) on the basis of the insurance motive. He nevertheless ascertains that it is impossible to find a just starting point for constitutional analysis (Buchanan, 1986, p. 271). For that reason, any institutional discussion – and all attempts of constitutional reform – has to "start from here" (ibid.), that is from the status quo with all its existing entitlements and claims. However, the status quo is always built on some prior natural order, and therefore always contains elements that reflect the natural distribution: "[...the] anarchistic equilibrium [...] always exists 'underneath' the observed social realities" (Buchanan, 1975, p. 79).

What is more, also the determination of the status quo as the relevant starting point is an implicit value judgement: it necessarily entails the recognition of all embodied claims and entitlements, reflecting the natural distribution. Starting from here, pareto-superior change can only rarely be found, recalling the test of constitutional efficiency.[12] And when Buchanan even states that "meaningful limitations must be placed on the sort of changes that are to be allowed" (Buchanan, 1962, p. 346), he ignores possible shifts of power relations in the natural distribution. These latter "always existing beneath the status quo" may require procedures for institutional change not to be fixed on the constitutional stage. The shifts of the hidden natural distribution in the end decide upon changes of the tolerance premium, and this process does not stop at constitutionally agreed-on rules. Finally, given the emphasis on the status quo, Buchanan's fierce critique of the existing welfare states is astonishing. He generally blames the modern welfare state to represent the "mistakes of almost a century" (Buchanan, 1986, p. 182). But if today's welfare states were the expression of rightful claims and included the actual tolerance premium, their legitimation would reasonably have to be ascertained. This issue will be reconsidered further below.

4.2 Economically weak and politically strong

A precondition for the contractarian tolerance premium to be paid is the capability of potential beneficiaries – in fact everybody – to successfully claim what they expect in return for the

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12 In this context, Ulrich (1997, p. 205 f.) locates the "status quo problem": it is not the "fairness" of the starting point itself which is of much relevance in a framework where (constitutional) pareto-optimality is the evaluative norm, but the relative advantages on the basis of the status quo. This bias is exacerbated by the fact that the distributive incidence of probable gains from trade leading to pareto-superior situations is highly determined by the status quo distribution itself.

acceptance of the constitutional contract. In theory, potential beneficiaries are at most quantifiable, but certainly not identifiable. The individuals are assumed to pass through the veil of uncertainty, and a perfect veil erases any individualized knowledge (e.g. Neumärker, 2002, p. 14). But in the somewhat less theoretical concept of Homann/Pies the perfection of the veil seems quite reduced. Referring to a potential renunciation of violent actions serving as a threat, the authors claim that even those individuals who are not willing to participate in private trade deserve to be paid the tolerance premium (Homann/Pies, 1996, p. 220). But how could this case appropriately be incorporated into a social contract? Within the authors' concept, anyone could threat not to take part in the market in order to extort a high premium from the collectivity instead. This would be an ordinary situation of rent-seeking.

All the same, the case seems plausible as long as the threats bear some credibility. But all those who obviously lack the capability either of carrying it out or of resorting to productive action are of no inherent interest in this paradigm, for they simply could not contribute to any "gains from trade". The example of the disabled seems to suggest itself (Kohl, 2009, p. 36): disabled persons are normally unproductive in a strict economic sense and thus do not provide any gains from trade for other individuals. For Homann/Pies this is not yet a problem, because an insurance element is always a part of their tolerance premium, and any risk-averse individual would have approved an insurance in case of accidents that lead to significant disabilities. Referring to the investment aid element, one could additionally state that the presence of people with post-natal disabilities left to their fate could frighten and discourage "productive" individuals (ibid.). But the case of natal disabilities is not embeddable in this framework anymore, as they do not directly affect any (productive) individual. Refusing support to handicapped with natal disabilities does not entail negative consequences, neither in the form of poverty externalities nor by jeopardizing any productive and probably risky effort.

There are several conceivable ways out of this dilemma. First, one could interpret existing transfers to all kinds of disabled as a compensation for externalities incurred by relatives assuming care functions (Volkert, 2000, p. 34). This would be some kind of indirect insurance. Likewise, it could again be resorted to altruistic motives on the part of the productive individuals (ibid., 23 ff.). But both possibilities do not bring the argument much forward, apart from the fact that they are not considered in the Homann/Pies-model anyway. After all, the example clarifies two points: first, that it is difficult to justify the existence of the welfare state with its productivity for the market, and secondly, that a model of a tolerance premium consequently has to go beyond the former function.

But before tackling this, it is fruitful to generalize the, admittedly, rather specific example of the handicapped. The latter eventually comes down to the problem of why exactly the economically weak individuals are implicitly assumed to transform into politically strong ones, capable of claiming their tolerance premium. Or else, why those who potentially hold little power in the market should hold much power in institutions (Priddat, 1996, p. 243).

At first glance the contractarian answer is straightforward: even if the veil of uncertainty was as thin as to allow for knowledge about individual positions, the unanimity requirement would provide every participant – whether economically weak or strong[13] – with a constitutional veto right (ibid., p. 241). The social contract has to be approved by all members of the society, so as well by the economically weak ones. But such a dogmatic standpoint somehow fails to recognize that any incremental improvement much below observable transfer amounts would already be approved by the poor (disregarding the veil of uncertainty for the moment). What counts is the superiority of the postconstitutional expectation relative to the natural distribution, also if for some individuals a subsistent level can only hardly be reached in either state. Again, even more relevant is the fact that Homann/Pies' gains-from-trade paradigm delivers no reason for including all individuals of a society into an institutional order. The ones that neither have the potential to offer any goods on the market nor the credibility to obstruct the functioning of the latter are basically of no interest within the hard core of the *Ordnungsethik*. If it is only due to their affiliation to a constitutional community that those individuals claim their rights, the agreed-on order will probably not be blessed with stability anyway.

Of course, the exclusion of the unproductive is neither very realistic nor the explicit purpose of the authors. But Buchanan himself must have identified this potential dilemma by admitting that "an all-inclusive collectivity could scarcely be organized voluntarily [...]" (Buchanan, 1975, p. 39). Considering the provision of public goods, there may arise the problem of potential free-riders who strive to achieve differentially larger gains or lower costs of the public good by threatening to object to the provision. The other individuals, confronted with the excessive claims of the freeriders, would at some point equally be unwilling to agree to the provision, and the latter would eventually break down. To resolve this dilemma, Buchanan proposes to coerce recalcitrant individuals (the freeriders) into accepting rules which secure equal treatment (ibid.). The intention of this proposition remains unclear as it stands quite apart from the foundations of methodological individualism. Brennan/Buchanan acknowledge this at a later date when they state that "[...] the moral force of an obligation to keep a promise is blunted [...] if the circumstances surrounding the giving of the promise involve nonvoluntary elements" (Brennan/Buchanan, 1985, p. 102).

4.3 The limits of overcoming dualism

A more general critique has to concern the "social policy for the market". Distinguishing it from the orthodox standpoints of social policy "through" or "against" the market, Homann/Pies present this conception as the key to overcome any dualistic conception of social policy. But already the designation, which literally proposes a subordination of the welfare state to the needs of the market, raises doubts about the soundness of this attempt. Blümle/Goldschmidt (2004, p. 186) locate a primacy of economic over social aims which would even go beyond

13 As we slip into conflict-economic considerations "economic strength" is a more appropriate attribute for individuals than "productivity". This because individuals are assumed to have two means of deploying their resources: peaceful production and predatory appropriation (e.g. Anderton/Carter, 2009). More about this further below.

the motivation of leading a social policy in the logic of the market. They oppose social policy *for* to social policy *against* the market, considering the former to be caught in the dualistic antagonism as much as the above described social policy *through* the market which is usually the synonym for the "efficiency position" (ibid., 182).

The tolerance premium of the *Ordnungsethik* neither really denies the interdependence of allocation and distribution (Homann/Pies, 1996, p. 218), nor does it leave any doubt about where to put the emphasis. When the authors call inequality a "social asset" and state that "it is in the interest of the weak that also the strong are supported [i.e. their tax burden is moderate, n.b.a.]" (ibid., p. 220, t.b.a.), allocative considerations clearly predominate. Even though this could be expected, it is not the constitutional feasibility of possible postconstitutional arrangements which is their guideline. In the gains-from-trade paradigm the productivity of social policy is what counts instead, and this up to the point where the question about extending or retrenching the welfare state seems redundant. It is not at all comprehensible how the authors come to draw these conclusions given their three-pillar model of the welfare state comprising insurance, tolerance premium and investment aid.

Considering some more specific policy recommendations this evaluation can be underlined: Homann attributes his propositions to the concept of the activating welfare state. His aim for any welfare state reform is to reduce wrong incentives on the part of the beneficiaries (Homann, 2003, p. 112 f.). A much discussed example of such wrong incentives is the claim that a transfer level of unemployment benefits fixed too closely above relevant wage levels would result in voluntary unemployment as it reduces the employees' motivation to assume work. Now, if the transfer level, allegedly causing wrong incentives, is regarded as the tolerance premium, it can hardly be claimed to be reduced just due to a disequilibrium on the labor market. This would endanger the stability of the protective state, because the tolerance premium would then probably not be paid its full amount anymore. Hence, the incentive argument obviously collides with the tolerance premium in this example. That also does not change much when we consider the latter example on a macroeconomic level (Priddat, 1996, p. 247): in the face of an increased threat potential, unemployment benefits would have to rise. The lowest wages would consequently need to follow in order to keep the extent of the incentive gap. In traditional macroeconomics this causes unemployment, which most likely boosts the required tolerance premium even more, a "vicious circle".

Apart from the above example, there is a logical objection to the incentive view: the contractarian tolerance premium should be given even to those individuals who do not even participate in the established market order, but simply tolerate it (Homann/Pies, 1996, p. 220). Consequently, even the ones renouncing to work would receive it, disregarding any incentive reflection.

The reason why the above dilemma is not directly visible in the concept of Homann/Pies is that the form of their tolerance premium is quite empty, and in particular not expressed in terms of direct redistributive transfers. Homann's three-pillar formulation actually comes down to the insurance motive carrying itself the by-products of the tolerance premium and the investment aid. And if an insurance is still what risk-averse individuals establish while maximizing the expectation of their lifetime utility, there is no reason why Brennan's self-protection motive could not likewise constitute a tolerance premium. Going one step further, even the fact that the authors claim the asymmetric information problems to be solved more efficiently under private law – a view which was already rejected above – leaves hardly any room for a public welfare state as such.

To conclude, some remarks about the dualistic remains in some of Buchanan's propositions: As it is made clear in *Liberty, Market and State*, one of his motivations was to derive a normative theory within which a justification for retrenching the (existing) welfare state is not the necessary outcome but can at least be deduced (Buchanan, 1986, p. 179). Yet, even though the elaboration of specific policy recommendations is explicitly not the aim of this approach, not all reflections follow this precept. Goldschmidt/Neumärker (2008) analyze the way how several economic strands ponder the tendencies to the privatization of social processes and the politicization of market processes, postulating that an integrative approach promotes none. As to Buchanan, they locate an over-emphasis of the politicization problem expressed in the advocacy of a very limited range of state-run activities (ibid., p. 8). Considering existing welfare states, Buchanan even locates a large amount of illegitimate redistribution arising interest-driven efforts at the expense of enhanced distributional equality (Buchanan, 1991, p. 245). Nevertheless, as mentioned above, the option of a tolerance premium with redistributive elements is more present in Buchanan's work than in the approach of Homann/Pies.

4.4 Investment aid and moral hazard

The remaining by-product of the insurance motive in the *Ordnungsethik*, the so-called investment aid, equally needs some critical examination. The investment aid is a consequence of the security that social insurance provides for risk-averse individuals in the market order. The existence of a social insurance is assumed to take the individuals' fear of any personal investment as it lowers the opportunity cost of a failure. An insurance could enhance the necessary risky investments and thereby raise the performance of a market economy as a whole (Pies, 2000, p. 125). Or in other words: it could "encourage the individual to participate in the both risky and socially productive game of the market" (Homann/Pies, p. 221, t.b.a.).

Even though this seems plausible, it has to be asked whether individuals at all have the choice which is ought to be influenced by the investment aid. Where should they actually invest? Certainly they are not entrepreneurs on the average, and it is hard to think of which additional risk individuals, let us now think of employees, should take personally (Priddat, 1996, p. 245). A vast majority of those for whom the existence of a social insurance is an important factor in decision-making can reasonably be assumed to concentrate on keeping their position, respectively their job. An investment aid simply cannot exist for them, as there is nothing, respectively no opportunity to invest. Their only way is in fact to look for a job and income on the labor market (and to keep it). This is even more the case for the unemployed, however they

certainly demand their tolerance premium. Seen from this angle, the investment aid is rather the opposite of the tolerance premium than its complement. We could alternatively assume with Piven/Cloward (1972) that for the poor not a high but a low relief has the intended motivational or labor-regulating function. This may be explained in the sense that low unemployment benefits make the active work force fear the fate of the unemployed. In this case investment aid and tolerance premium diverge even more.
There is yet another caveat to the investment aid argument: it also stands against any moral hazard proposition which is made by the same authors[14]. But one cannot assume individuals to be motivated by the security of a social insurance and at the same time to lean back in the presence of allegedly too generous transfer schemes. Either they "invest" in their job by performing well, or they reduce their work efforts and in the extreme case even voluntarily accept paid unemployment. But doing either at the same time is not possible.

4.5 Postconstitutional ignorance

As opposed to Rawls, Buchanan represents a social contract theory characterized by an extensive postconstitutional indeterminacy. This is probably best expressed in his diagnosis of "that which emerges emerges" (Buchanan, 1986, p. 273). By this it is stated that any evaluation of institutional arrangements has to be based exclusively on the process of interaction by which they were achieved. On the one hand this entails a very broad range of possible postconstitutional arrangements and on the other it strengthens the stability of any arrangement once reached. This is because an institution can only legitimately be declared inefficient if it can be changed by unanimous agreement (Buchanan, 1962, p. 353). The indeterminacy of the constitutional contract combined with its normative rigidity therefore inhibits most further economic evaluations on the basis of more stringent assumptions. The economist is caught in a "criterial void" (Kersting, 1994, p. 349, t.b.a.). Even though this is Buchanan's intention to a certain degree, it likewise signifies that one abstains from many institutional discussions which cross these strict normative assumptions. And second, the (immanently correct) recommendations arising these assumptions simply are not always of much relevance, as well for what concerns the tolerance premium. An example is the evaluation of a collective tax on wealth: according to Brennan/Buchanan the introduction of such a tax would violate "all criteria of 'fairness'" as it is a retrospective intervention referring to actions which have been made in the past under another set of rules (Brennan/Buchanan, 1985, p. 138). In reality, however, wealth taxes were obviously introduced, and probably this has something to do with preventive acts aimed to secure the protective order.
In any case, both on the tax and the expenditure side, individuals are essentially presumed

14 Homann (2003, p. 113), for example, underlines his conviction about the presence of moral hazard in insurance with a personal experience: his motor liability insurance allowed him for 30 years to drive faster than he would have done otherwise.

to be powerless to postconstitutionally affect the fiscal activities of the government (Brennan/ Buchanan, 1980, p. 135). The latter is still a Leviathan who exploits taxpayers within reach in order to use the thereby gathered revenue for its own consumption. This view slightly differs from positive public choice literature where the government is an in-period utility- and vote-maximizing actor (see e.g. Downs, 1957). Given that voters discipline the executive power through elections, they are indeed able to influence fiscal activities in a postconstitutional setting. In public choice this influence is often analyzed in the form of rent-seeking activities exercised by all kinds of pressure groups whose aim is to use public resources in their own favour by means of the collective interaction process (see e.g. Tullock, 1998). Buchanan also considers these issues, as it becomes clear with the quote that "there is no reason to expect that simple majority voting [i.e. postconstitutional voting, n.b.a.] would result in a net transfer of real income from the rich to the poor" (Buchanan/Tullock, 1962, p. 196).

If we however simply assume a "pressure group" of the poor (respectively of all those dependent on and striving for social transfers) to exist in this rent-seeking environment, some of the public funds will definitely flow towards the poor. Normally their lobby is surely not the strongest one. But if we additionally consider the exigencies expressed by the tolerance premium, that is the relevance of the funds for the stability of the whole protective state, the transfers towards the poor may amount to quite substantial levels.

In any case, in order to gain additional insights, it is appropriate to leave the rather rigid and up to here quite extensively exploited framework of the constitutional-economic two-stage theory. Within this theory the long-term compliance to the agreed-on set of rules is always tacitly assumed, and a low level of dynamic development thereby presupposed. This is tried to be overcome in the remaining chapter in which the focus will lie more on postconstitutional approaches.

5. The need for a tolerance premium beyond its origins

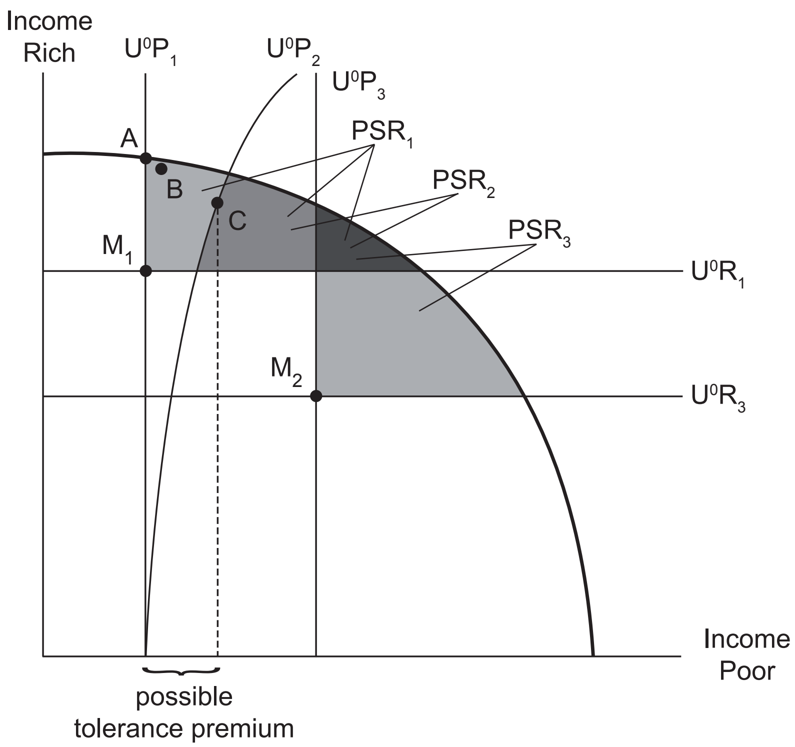
5.1 Conflict-economic considerations

The static nature of the contractarian approach, at least in the version of Buchanan, can be a drawback for the analysis of the tolerance premium. Obviously, every collective order once settled can theoretically be altered in this paradigm, but the bars for constitutional reform are quasi insuperable. This is best expressed with the already mentioned "Wicksellian test of conceptual unanimity" (Buchanan, 1986, p. 180) which in practice comes down to a normative justification of the status quo.

As shown above, the status quo can reasonably be expected – and is expected by Buchanan – to reflect the natural respectively anarchical distribution at least to some extent. And this latter can just as well be equilibrium distributions, as Bush/Mayer (1972) show. Therefore it has to be

analyzed what happens in the presence of shifting distributions of endowments on the hidden natural state. It is most important that these endowments are not only of productive but also of destructive nature: the anarchistic equilibrium existing "'underneath' the observed social realities" is the origin of exchange "in the shadow of conflict". In order to overcome remains of natural law, it is thus appropriate to return to the anarchistic level as the point from where to start from and as the distribution which really conditions the extent of the tolerance premium.
Starting here, the analysis of the tolerance premium necessarily becomes more dynamic, and any reached collective agreement likewise less stable. In this context, Zintl rightly asks why in the social contract theory the order is actually assumed to be stable given that it is perceived as an armistice, and why the individuals should not be assumed to permanently aim to improve their bargaining position (Zintl, 2000, p. 114). Indeed, there is no social contract that impedes individuals and groups from continuously adjusting the division of their efforts between production and conflict. The options of the productive exploitation of controlled assets and the defense of the own "resource base" are always available, as Hirshleifer (1995, p. 27) puts it. The dynamics of the tolerance premium could then be studied in a conflict-economic setting which analyzes distributional outcomes of the interaction of competing actors with specific preferences, opportunities and perceptions (see e.g. Hirshleifer, 1988). For the sake of conciseness this is not done formally here, yet some possible insights are addressed graphically:

Graph b: Dynamics of conflict
Source: adaptation from Hirshleifer (1988)



The classical two-player setting, as it is depicted in graph b, may stand for the interaction of two monolithic groups, the ones interested in paying a tolerance premium for protective reasons and the potential claimants and beneficiaries of the latter.[15] Further abstracting, these groups may be represented by the rich in power, interested in the quiescence of the poor. Point M_1 then designates the respective reservation levels in an expected anarchic equilibrium. Given classical, i.e. self-interested preferences, any income level incrementally higher than the reservation level at M_1 would please the poor and induce them to productive cooperation. A pareto-superior equilibrium could be reached anywhere in the potential settlement region (PSR_1), e.g. in a point such as B – which is here assumed to be located somewhat below the social opportunity frontier due to the "leaky bucket". This process, however, does not ensure the establishment of a substantial tolerance premium, because a potential transfer could as well be infinitesimally small (like depicted in B).

We could therefore further assume antipathic preferences on the part of the poor expressing an aversion for too unequal income distributions. In this case, the indifference curve of the poor bends to the right (U^0P_2), rendering any cooperative outcome to the left of C impossible, given the income level of the rich. The tolerance premium would then amount to the horizontal distance AC for this distribution (with pareto-superior outcomes located in PSR_2). Alternatively, we could start with more equal reservation levels for the two groups, e.g. in a point such as M_2, leading to a new potential settlement region PSR_3. In this case it could yet again be asked to what extent the economically weak, respectively the claimants of a tolerance premium, can be expected to stand their ground in an anarchical environment. In any case, for the dynamics of the tolerance premium the size of the potential settlement region is crucial: this totality of cooperative outcomes is the smaller the higher the threat potentials of the parties are. In a changing environment, shifts of outcomes within but also outside of the PSR happen, inducing an adjustment of the tolerance premium in the latter case.

Abandoning the technical considerations of conflict, it can subsequently be asked how deviances from cooperative and productive behavior actually occur. For individuals, predatory actions like robbery or looting suggest themselves. In economic literature, the optimal social reaction to contain individual crime was extensively analyzed. Becker (1968), for example, simply examines the optimal amount of costly enforcement of certain rules. This is a very one-dimensional approach, but it is basically in line with strict contractarian approaches that simply presuppose the postconstitutional enforcement and compliance of rules. A more developed concept is Brennan's above presented mix of appeasement, repression, and threat policies. The object of interest of his model is the prevention of revolution, and rightly so. Considering revolution is much more relevant for the stability of a given order than just examining individual crimes and appropriate reactions to it. After all, criminals basically accept an existing rule structure, they just do not follow it personally. Or, as Böhm puts it: "The thief is not a revolutionary, but a conservative friend of order. He wishes an order followed by everyone but himself" (Böhm, 1957 , t.b.a.). The revolutionary's explicit goal, however, is to overthrow the existing system. Since revolutions obviously do not take place individually, it is worthwhile to return to a group-

15 Collective action problems which could arise from this assumption are tackled in section 5.3.

based model for analyzing them. But this poses difficulties for economics where the initiation of a revolution is always sought to be endogenously deducible from the level of the individual homo economicus. Yet, before this issue will be tackled, a nearby alternative to revolutions is considered: elections.

5.2 Elections as a barometer of unrest

Revolutions do not happen every day. But drawing the conclusion thereof that the tolerance premium would either always be paid or even be an unnecessary instrument is as static an argument as flawed. After all, in many countries elections take place and are exploited as the main channel for transforming individual preferences into collective action, disregarding the question of how frictionless this works in reality. However, elections might as well serve to channel revolutions. Piven/Cloward (1972, p. 40) argue that universal franchise and periodic elections mainly serve as a "barometer of unrest" for the ruling class: political incumbents react to disaffections of large groups of voters, "whether expressed in the street or at the polls" (ibid.), by altering the institutional and economic arrangements.

Considering for now one of the most prominent economic models for the analysis of electoral behavior and outcomes, the median voter theorem (Downs, 1957), the insights for the tolerance premium are scarce: if under the known range of restrictive assumptions of this theory politicians committed to positions closest to the median voter's preferences, the tolerance premium would hardly be of much importance. After all, in the form of a transfer it could is most probably important or even paid to far less than half of the population. Furthermore, it is not at all said that welfare and income distribution is a political dimension important enough to (solely) determine the outcome of elections.

Built upon the median voter theory, there is however the extension of Meltzer and Richard (1981): these authors claim that if the median voter's preference was a function of the distance between the average and his own income, additional redistribution would always be advocated in the presence of a right-skewed income distribution (i.e. with the median voter's income below the average income). The main implication of this model is thus a positive correlation between the inequality of income and the demand, respectively the provision of redistribution. Whereas a widespread interpretation of these finding was that democracy "unfortunately" leads to big government (e.g. Ross, 2006) it might as well confirm a correlation between the discontent of the poor, respectively their threat potential, and the size of the tolerance premium. The payment of the right amount of transfers is then an inevitable electoral condition for the ruling party to stay in power.

Of course, the objections to the assumptions of the median voter model equally hold for Meltzer/Richard. Again, if for example it was not only the issue of income distribution which is considered in the political process, but a variety of dimensions reflecting multiple-peaked preferences on the part of the voters, the model would not be applicable anymore. But as for the dependence of the protective and productive state, the issue of paying the right tolerance premium is probably the most relevant one for the stability of the system as a whole. Hence, it would have to be the guideline of any politician in power.

Yet a more fundamental caveat to the compatibility of the Meltzer/Richard-model with the tolerance premium is the fixation on the median voter itself. Also given a very right-skewed income distribution, the median voter can be assumed to be located somewhere in the "middle class" and not among the poor (leaving more specific definitions of these groups aside). Tackling policies towards the median voter, however, would not be expressed in the establishment of universal programs like a subsistent level of social protection or an equally distributed income tax. Narrow programs catered to the middle classes seem much more plausible under Meltzer/Richard. A good example for such programs are all kinds of government-provided public goods co-funded by consumers, for example the financing of education (Fernandez/Rogerson, 1995): if fully provided by the government and financed through linear taxes, education obviously has the effect of a transfer from rich to poor. With a direct co-financing, however, middle classes can be made better off. This because on the one hand they would not incur their part of the costs of the provision to the poor who could by no means afford to demand educational services in case of co-financing. On the other hand they might even be subsidized by the poor who can still be expected to bear a moderate share of the tax base (ibid.), the second source of funds.

To summarize: even though its main proposition can be regarded to back the existence of a tolerance premium, the implied redistributive effects of Meltzer/Richard rather contradict it. The denial of this proposition would imply to attribute any redistribution towards the middle class likewise to the tolerance premium, but this would not be too purposeful. Hence, it would be reasonable to conclude with Tullock that "what we actually observe in democracy is that majority voting does not redistribute much money to the poor and does redistribute a great deal of money to people who are by no means poor" (Tullock, 1970, p. 252). Let us therefore leave it at that with the analysis of elections.

5.3 Reconsidering collective action problems

Rational choice theory offers no direct way to explain individual participation in social movements. In *The Theory of Collective Action* – Olson's prototype analysis of the collective action problem – it is argued that self-interested individuals have no interest in contributing to the provision of public goods[16] because freeriding is a more promising strategy (Olson, 1965, p. 2). This especially holds for large groups where the impact of an anonymous individual on the group is so small that his participation will not make much of a difference (ibid., p. 62). This is a well-known finding, and one which obviously collides with the intuition that individuals with similar interests and goals could form a group and act collectively in order to achieve these

16 Evaluating public goods, especially revolutions and other forms of collective mobilization are here considered.

goals.[17]

Obviously, collective mobilizations of large groups nevertheless occur in reality. It thus has to be examined why they are initiated and by whom. Olson (ibid., p. 51) proposes that in large groups only a "separate and selective incentive" would induce an individual to act in a group-oriented way. As to revolutionaries, this incentives could for example be expressed in their appetite or occupational decision to become a member of the ruling class in case of revolutionary success. Following this theory, Tullock argues that the largest private gains from revolutions can be expected to accrue to "senior officials" whose participation contributes to a rather good chance of success in overthrowing the government, and who would most probably be high in rank thereafter (Tullock, 1971, p. 98). Such senior officials can thus be expected to initiate a revolution. What then remains to be evaluated is whether they are numerous enough to overcome the dilemma for the whole group of interest.

The relevant point to be made is the following: if for individuals the plausible reaction to the absence of the payment of the tolerance premium is a criminal action – which is eventually consistent with the established order – for a group this will be a collective mobilization aimed at destabilizing the established order, a revolution. Even if it is legitimate to examine or even negate the outbreak of revolutions within a rational choice paradigm, one could as well just take this for granted, given the simple fact that revolutions indeed happen. To draw a parallel: in *The Power to Tax,* Buchanan and Brennan (1980) make the fundamental assumption of the "Leviathan as a monolith". They affirm that the governmental model of the Leviathan would in reality be composed by many units and individuals who continuously interact with each other (ibid., p. 28 f.). But by simply referring to Smith, they presume that (led by an invisible hand) "something close to 'Leviathan's interest'" emerges from the interaction of the various executive decision makers (ibid., p. 29). This quite fanciful analogy actually confirms the ad hoc character of the Leviathan assumption which is of course not the only plausible model of a government. Be it as it may, the latter example shows that it is not so unusual to make simplifying but realistic assumptions when it comes to the explanation of observable monolithic actions taken by collectivities. Especially in social sciences this is a common way to proceed. Let us therefore briefly consider the following two approaches which stem from social sciences and are of particular interest regarding the tolerance premium.

The "resource mobilization theory" (e.g. Piven/Cloward, 1972) underlines the continuity of social movements and institutionalized collective action, based on the rationality of the movement as a whole. Its starting point is, as Jenkins (1983, p. 528) states, that "the basic goals of movements are defined by conflicts of interest built into institutionalized power relations". Or, adapted to our topic: the threat potential of social movements is what contrasts and overcomes the inability of the ruling class to pay the tolerance premium.

17 Elinor Ostrom strongly contends Olson's theory and its orthodox interpretations. In *Governing the commons* (1990) she shows that it is flawed to think of the "tragedy of the commons" as an inevitable consequence of commonly held property: "I would rather address the question of how to enhance the capabilities of those involved to change the constraining rules of the game to lead to outcomes other than remorseless tragedies" (ibid., p. 7).

Building upon the premises of the resource mobilization theory, the "power resource theory" (e.g. Korpi, 1978) simply defends that the mobilization of power exerted by social classes is the crucial variable in explaining social policies in capitalist regimes. Analyzing parliamentary politics as a "democratic class struggle", Korpi argues that welfare state developments most likely reflect class-related distributive conflicts and partisan politics (Korpi, 2006, p. 3). He defines social classes as categories of "patterns of resource and risk distributions among actors on labor markets" (ibid., p. 7). This factually specifies power relations in industrial bargaining to be the main factor for the development of the welfare state – either indirectly, by exerting pressure on the political institutions, or directly, via cabinet participations of the political left. Disregarding the possible objections to the nature of this approach, a positive correlation of the extent and longevity of the left's participation in power and the institutional articulation of "positive liberties" is probably common sense.

Concerning the tolerance premium, the designation of collective bargaining to be the main driver of institutionalized social policy is particularly fruitful. On the micro-level of an individual firm or industrial sector we can as well find all the elements which account for a stable relationship between the welfare state (respectively the wage settlement within collective agreements) and the protective state (respectively the containment of strike action). The workers' threats of striking, occasionally carried out, is an indicator of the general threat potential of "tolerance premium beneficiaries" – always assuming that these groups coincide at least approximately. What is more, the issues of collective bargaining – wages, working hours and conditions – are rather one-dimensional. Consequently, they do not present the problems, posed by elections and ordinary political decision-making, that the fragmentation of political and special interest groups organized around a broad range of specific issues makes it difficult to isolate the influence of the tolerance premium.

Within social sciences, the power resource theory is challenged by the "varieties-of-capitalism" approach (Hall/Soskice, 2001). The latter essentially regards the modern welfare state as the product of the employers' pressures for social policies offering basic programs relieving themselves (again a "social policy for the market"). Especially in an economic environment requiring asset specific skills, employees need incentives to invest in these skills. Without being insured, however, they would not make such investments, given the limited transferability of their skills on the labor market. But the individual employers on their part cannot credibly make such investments neither, as they fear freeriding on the part of their competitors. The state is thus needed to step in. However – questioning this theory – so far it was not too common to see employers being protagonists in claiming the establishment or even the extension of welfare states.

Nevertheless, even though contending about the just causalities, the bottom line of the two approaches does not differ too much. Whether employers actively promote an adequate welfare state for their own protection or employees claim it in their own interest: the welfare state is a product of economic power relations either way.

5.4 Social feasibility

It is not the purpose of this work to provide an in-depth analysis of the empirical evidence of the tolerance premium. First this would hardly be realizable within the length of this thesis, and second it is neither forcefully fruitful. The tolerance premium is a dynamic way of reasoning about the existence of the welfare state, either from a contractarian-constitutional perspective or by means of more dynamic approaches within a postconstitutional environment. Yet it is not an exactly quantifiable program or transfer which could be examined.
Nevertheless, there is of course much empirical data that can be interpreted in the light of the tolerance premium. This is the case with a whole strand of economic literature which empirically investigates the correlation of macroeconomic variables like economic growth and the size of the state of different countries. Alesina/Rodrik (1994, p. 485), for example, postulate that above a certain level "conflict over distribution will generally harm growth" due to disproportionally high levels of taxation. This prototypical finding well allows for the illustration of two diverging interpretations. One could interpret this result as an exemplary confirmation of the equality-efficiency trade-off, insofar as claims for more equal distributions can be blamed for harming growth. But this would be short-sighted, and the tolerance premium shows why: having reached a situation where conflict over distribution harms growth, it is of no relevance anymore whether aspirations for more equality curtail economic efficiency or not. An increased level of efficiency is simply not feasible starting from such a situation. If the night watchman state solely is not tolerated by a relevant part of the population, it cannot be presumed to exist and ergo neither exercise its functions of ensuring property rights. And what is more, the above quote conversely would state that once conflict over distribution has been settled, i.e. a situation of more equal distribution has been reached, growth might be retaking.
More interesting would however be to ask how such a situation described by Alesina/Rodrik can actually come into existence. Ultimately their quoted correlation equally states that greater equality of wealth is conducive to economic growth, if it does not stem from taxation. They likewise ascertain that "policies that maximize growth are optimal only for a government that cares solely about pure 'capitalists'" (ibid. p. 465). But this is not the whole truth, because at a certain point pure capitalists dig their own grave by impeding to implement "growth-harming policies", for they most probably would not survive revolution as capitalists. Hence again: in the same way that we could have a collective action problem for the initiation of a revolution on the part of one group, this may exist for the prevention of revolution on the part of the other group. Indeed, it is not so obvious why the "capitalists" should get together to pay the tolerance premium, instead of just crying for "growth-promoting" policies. Individually they would never do this, unless local labor peace is threatened.
Finally, reasoning more generally about the feasibility of economic policies, a standard macro-economic discussion which strongly relates to the tolerance premium is the following: as a consequence of globalization, respectively increased international openness, the continental European welfare state is often considered as a burden to economic development. The ad-

vocates of welfare state retrenchment praise the allegedly positive effects of an international race to the bottom in curtailing social policy measures on the economic competitiveness of the different locations. Now, disregarding the question whether they are actually right empirically, they fail to see that at some point such a policy undermines any base of international competition as it is commonly perceived. There is actually hardly an orthodox economist who would not support the idea that the most fundamental institutions for economic prosperity are the protection of property rights and the freedom of contract, in short the existence of the protective state. But in praising international competition over the extent of welfare states, this idea almost seems not to be valid anymore, the protective state is simply taken for granted.

6. Conclusion

The tolerance premium, as it was advocated in this thesis, is a multilayered concept for deducing the existence of the welfare state and a specific approach to examine the latter. However, it does not represent a clear-cut model which is unambiguously definable and empirically testable.

Based on the contractarian theory, it was shown how Homann/Pies introduce the tolerance premium in their "social policy for the market" which aims to overcome the dualistic perspective of social policy prevalent in "orthodox" economics. Their argument is that the constitutional agreement to a protective institutional order is heavily conditioned by the prospects of a more or less extended productive respectively welfare state to emerge. By this, they underline the protective element of social policy which is widely absent in most traditional theories of the welfare state like the insurance or charity motives and all models relying on a benevolent social planner aiming to adjust for market failure.

Buchanan's theory thereupon offered some additional elements, partly strengthening the tolerance premium and partly showing new ways to interpret the concept. Especially the possibility of a preconstitutional transfer as the very first element for collectively overcoming anarchy is to be mentioned, but equally the redistributive character of public goods. Nevertheless, it was by examining Buchanan's work that the main caveats to the presented tolerance premium became obvious. One illustration of this was the incompatibility of the dynamics underlying the possible claims for a tolerance premium with the fixation on the status quo as the irrefutable starting point of any institutional change.

In order to overcome those caveats, it is worthwhile turning to the approach of conflict economics which disposes of adequate instruments to interpret the tolerance premium dynamically. This is the case as well for Meltzer/Richard's theory, yet more in a parliamentary than in a revolutionary environment. Additional insights were also drawn from social sciences, respectively the "power resource theory" and the "varieties-of-capitalism theory" which both interpret the welfare state as ultimately being the reflection of power relations in collective bargaining.

Obviously, also these theories are neither all-embracing nor incontestable. But they are very useful for overcoming some flaws of the contractarian models.

As to these latter, the main conclusion is that there is simply no two-stage theory in the presence of a tolerance premium. If the threat of the poor not to accept a specific institutional structure inevitably links the productive to the protective state, there is no sense anymore in dividing the "two states". They are so interdependent that they virtually cannot be divided: the privateness of private goods – ensured by the protective state – is itself a public good and can thus be attributed to the productive state within which these goods are provided. This argument actually also delivers the foundation for any postconstitutional analysis of the tolerance premium.

Immediately following from the unity of the protective and productive state, the confrontation of equality and economic efficiency has likewise to be relaxed: the level of efficiency is simply irrelevant for all those outcomes which are not feasible in terms of equality. And the main variable conditioning the feasibility of outcomes is the threat potential of possible claimants of the tolerance premium, whether expressed behind the veil or in real world. Threat potential may also be available for those expected to pay the premium. Considering the recent revolutions in Northern Africa, for example, the public security apparatus could be observed to beat up the masses. In contractarian terms the aim of this must have been to actively lower the level of what the revolting masses can expect in Hobbesian anarchy. Moreover, threat potential can also exogenously arise or vanish. The best example for this is the breakdown of the iron curtain which released western capitalism from the necessity to continuously prove its harmonizing assets to the whole population.

Generally, the approach underlying the tolerance premium is not yet too widely acknowledged. This holds especially for economics. Therefore it needs to be deepened, and an interdisciplinary cooperation of economics and social sciences could prove to be particularly fruitful. Finally, even though it might be difficult to create unique standards in how to define and measure the tolerance premium, it is definitely necessary to take up empirical research in this direction.

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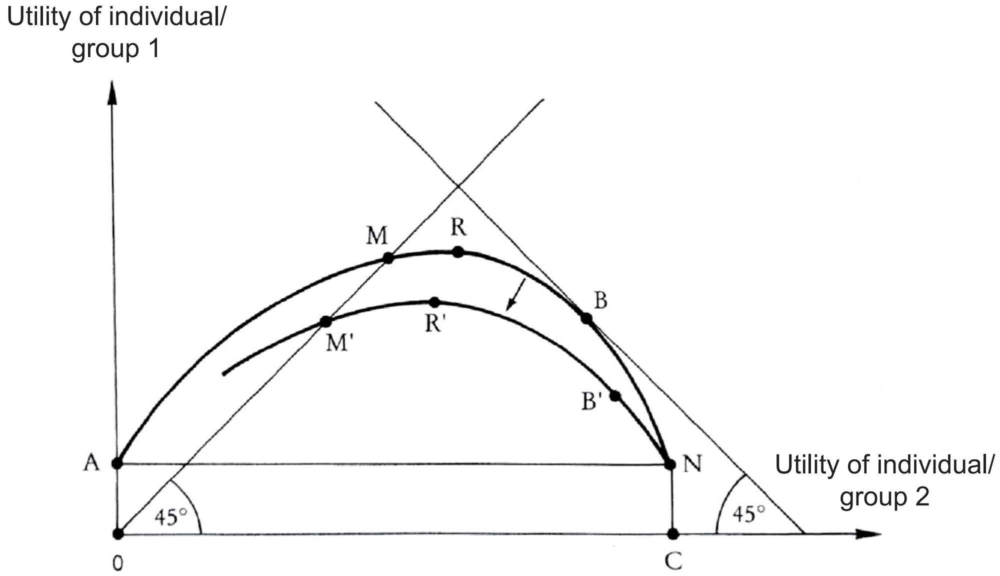
Appendix

Graph a: Utility levels and justice for different social welfare functions



Source: Blankart (1991, p. 92)

A social planner applies the social welfare function to the overall utility frontier of two individuals and obtains the desired allocation at the point of tangency. What each individual can acquire autonomously (A, respectively C) is what they are entitled to in a distribution based on natural law, as for example advocated by Nozick (N). Moving towards more egalitarian distributional norms, the trade-off begins and intensifies. At the utilitarian optimum (maximization of aggregate utility), the Benthamite B, individual 1 will have a reduced utility level due to redistribution and probably adjusted productive efforts. Yet, up to this point overall utility rose thanks to the transfers rendered to individual 2, given the usual assumption of increasing marginal utility. Moving further to the Rawlsian optimum (R) – the point of highest utility for the least well off –, the leaky bucket appears even in utility terms as overall utility shrinks. But turning to pareto-optimality, we can escape the equality-efficiency trade-off over the whole section from Nozick up to Rawls in this illustration: within this range, any exogenous application of a distributional norm does not leave room for unilateral improvements of one individual's utility without harming the other. This is not the case in the depicted situation of an equal distribution (M).
Blankart reconsiders the graph with groups of poor and rich on the ordinate and abscissa, respectively. In this case, tax evasion could present a new leakage – be it in an illegal form or merely "voting by feet" (Tiebout, 1956). The whole utility frontier in graph a would shift downwards, making the trade-off evident almost from the beginning of any redistribution.