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The Quality of Mercy:

Social Health Insurance in the Charitable Liberal State

by

Sherman Folland
Department of Economics
Oakland University
Rochester, MI 48309
1-586-752-5738
fax: 1-248-370-4275
folland@oakland.edu

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Abstract

This paper has two, mutually supportive purposes: 1) to show that the modern economic rationale for universal social health insurance is consistent with the classical liberal understanding of property rights; 2) to show that the writings of the leading liberal sages—Locke, Smith, Mill, and Hayek—are congenial to programs economically similar to universal social health insurance, and, in Hayek's cases, were specifically approving. It is hoped that these facts and reasonings, which are unlikely to be known *in toto* to those who do not normally study across the intersection of philosophy and economics, will encourage a dialogue that reasserts in a non-ideological way the neglected role of property rights in the health economic assessment of social health insurance alternatives.

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The system of competition and private property depends [on] namely that the owner benefits from all the useful services rendered by his property... Where [this] is impracticable ...competition will not produce the service. Hayek (1944:38).

My aim has been to indicate not only that the principles of justice fit our considered judgments but also that they provide the strongest arguments for freedom. Rawls (1971:214).

The quality of mercy is not strain'd, It droppeth as the gentle rain from heaven; ...It is twice blest; It blesseth him that gives and him that takes. Portia in *The Merchant of Venice* by Shakespeare.

These three quotations set the stage for an economic/philosophical theory that demonstrates a middle ground between those pro and con universal social health insurance (SHI) in the United States: Hayek expressing his clear understanding that private markets will fail when there are external benefits or costs, and Rawls revealing the high priority he placed on liberty. But, Portia's plea best foreshadows the point of my argument here. If an altruistic gift also benefits the giver, as in recent economic theories of altruism, then the case of health insurance meets the criteria of market failure not only as posed in mainstream economics but also as in the classical liberal view.

Social health insurance is now returned to the national agenda. "Social health insurance (SHI)" here will refer to any plan that covers the population universally or nearly so, provides at least an agreed upon "decent minimum" of health care, and does so by offering or subsidizing the purchase of the required health care insurance. Of course, voters will differ on which type of plan they prefer and some will prefer "no plan". From a property rights point of view, however, what each type of plan has in common is that it requires the taking of private property rights by government, that is, each is necessarily coercive to some degree.

A demonstration that an SHI is congenial to the classical liberal tradition requires that one confront its present day public interpretation, which more commonly sees the liberal sages as advocates of a laissez faire government serving a society of autonomous, perhaps even isolated individuals. The recent revisions to this history, led by Emma Rothschld (2001), are much needed. I will attempt to show from an economic reading of Locke, Smith, Mill and Hayek that these liberals 1) emphasized the benefits of human sociability and mutuality, 2) described favorably the uses of government where external costs or benefits exist, and 3) that such views were not merely incidental to them but were consistent with their broader philosophies. These four philosophers and economists were chosen to represent core liberal thinking; modern advocates of liberalism commonly refer to these four as among the founders of the tradition (Wolfson, 2004).

One practical value of a philosophical/economic investigation like this is to remove, as with Occam's razor, unneeded baggage from the economic treatment of liberty. We economists serve well, if modestly, by assessing the costs and benefits of potential public investments such as SHI; in the process we commonly and correctly consider the program's effect on both equity and efficiency. A more accurate conception of our liberal tradition reemphasizes our mutual and widespread valuation of libertarian concerns, many of which may tend to be overlooked in those cost/benefit calculations. These concerns do not simply go away by omission from our analyses; they are strongly held values across the American political spectrum and they are deeply embedded in our laws regarding the takings of private property. Inserting liberal theory into the health economic analysis of alternative SHI plans provides another, nontrivial dimension, because property rights impacts differ across SHI alternatives, whether a Canadian style plan, an employer mandate, or and individual mandate.

The paper is based on the economic reading of historical documents in conjunction with modern theories. Its innovation is to show a chain of reasoning from theories, each well known in its own context, with compatible theories from other contexts; it also provides new arguments on how to interpret them and link them together. The purpose overall is to demonstrate that the modern economic efficiency rationale for social health insurance is consistent with classical property rights theory and to show that the leading classical liberal sages wrote in support of similar applications of collective action. If successful, the line of argument provides an additional rationale for the support of an SHI, one that would join other viable rationales such as those based on economic equity concerns or on purely philosophical grounds. Section I demonstrates the logical thread from Locke to SHI. Section II shows how my argument is distinguished from other present day theories outside the field of economics. Section III demonstrates through commentary and excerpts that the central liberal sages supported in principle the modern economic efficiency rationale for SHI. Section IV concludes the paper with a discussion of the implications for our current national debate.

I. Reasoning from John Locke to Social Health Insurance

The Intersection of Economics and Philosophy

If there is a consensus among economists about collective action, it is that markets are preferred unless there is market failure, in which case collective action might improve social well-being, provided that government failures or other second best issues do not overcome the gains. This logic arises primarily from efficiency concerns, and thus the approach may seem too narrow in an ethical sense for some people. However, if we accept the conditions of the theory of efficient markets and if we further assume that market failures in charitable exchange have at the same time been eliminated, then efficiency goes a good way toward achieving a socially agreeable, equitable equilibrium. But, is the result equitable in a more fundamental, philosophical sense?

Fundamental issues of equity, involving justice and fairness, are often left to other disciplines, like philosophy or politics. Yet, the intersection of philosophy and economics has been explored fruitfully by both economists and philosophers (Rawls 1971; Nozick,1974; Marx, 1906; Arrow, 1975; Buchanan and Tullock, 1965; Hayek, 1960) with stimulating results. The goal of this section is to show that there is an unbroken and mainstream line of reasoning from the liberal tradition, beginning with Locke through well-seasoned theories of modern economics to a practical case for SHI in the United States.

Beginning from Locke

Locke makes a strong assertion of property rights: "Every Man has a Property in his own Person...This no Body has a Right to but himself...[and] The Labour of his Body, and the Work of his Hands, we may say are properly his" (Locke 1960:287-8).

Taking it from this point, assuming Locke's assertion to be true, suppose that people endowed with Locke's property rights consider creating a state. Since states in essence obtain coercive powers, the individual freely entering the state must either reject all infringements on personal liberty, and so reject the state altogether, or accept that the gains in material or social well-being will satisfactorily compensate for the requisite losses in liberty.

We humans universally and continuously do this, we trade off freedoms in many spheres of life in order to gain advantages of other kinds. We accept the restraints of civil and criminal law to gain security, maintain order and encourage trade. We accept coordinating rules and procedures on the job and codes of conduct in personal and family ties. We accept rules of the game in sports, rules of the road in traffic, and rules of thumb in most aspects of life (Wittman 1982). The prohibitions against the violation of other people's private property, given by the liberal philosophy, still hold during these tradeoffs as they are entered into voluntarily, though surely we would also require that the people involved be reasonably well informed.

James Buchanan and Gordon Tullock Take This Further

People who enter a state would wisely insist that the state's powers be limited and well-defined. A good constitution defines these limits, and sets out the means of acquiring the state's needed resources (Buchanan and Tullock 1965). We understand of course that a written document is not sufficient in itself. The limits to state power throughout U.S. history, for example, were maintained not only by the Constitution but also by a general skepticism of state power among the citizens.

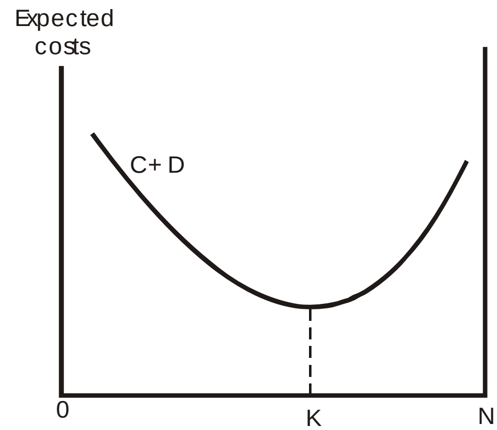

Figure 1.

Buchanan and Tullock then describe how a liberal state chooses the means to make practical, everyday, social decisions based on a less than unanimous agreement. Figure 1 explains the essential reasoning. Let *n* be the number of people required to approve a proposal within a voting population of size *N*, and let *C* + *D* reflect the costs of making the decision. The external cost *C* measures the side effects of making a decision, one where a less than unitary agreement is acknowledged as sufficient the official approval; this external cost declines as more people are required to agree to the collective action, because fewer then have not been left out, thus fewer have reason to complain. The decision cost, *D*, reflects the required effort and resources to produce the decision making process; understandably these costs rise as more and more people are sought out and induced to participate in the decision process.

Since external costs, *C*, decline with the number required for the decision, *n*, and since decision costs, *D*, rise in *n*, the sum of the two costs may determine a parabolic cost function as shown in the diagram. As in the example shown, the minimum cost of decision making occurs where the decisive fraction is set to the value, *K*, which falls well below unanimous agreement. Note also, that the optimum, in this case, *K*, differs from a simple majority.

We Americans find a 50 percent majority voting rule to be best for a wide array of decision making tasks. Cases of sub-50 percent rules occur less frequently in public matters though they are not uncommon elsewhere. In any case, Buchanan and Tullock showed that practical voting rules are congenial to Locke's property rights. By consenting to the constitution, in which it is made clear what decision rules will be applied by the state, the free individual precommits to practical, everyday decision rules. In this way, a simple majority vote to select a SHI in the United States could also fit the liberal principle.

The Problem of Consent

If we accept a majority vote on SHI, it is still necessary to look critically and closely at the people's "consent" to the original step. Can we claim that today's population of voters has genuinely consented to our Constitution?

Locke's answer to such questions, though well known to students of Locke, does not provide a good basis on which to presume consent. He argued that we offer "tacit consent" to the social contract and that this can be inferred from our use of state provided goods and services. His comment in the *Second Treatise* is:

> ...every Man, that hath any Possession, or Enjoyment, of any part of the Dominions of any Government, doth thereby give his *tacit Consent,* and is as far forth obliged to Obedience to the Laws of that Government, during the Enjoyment, as any one under it; whether his Possession be of Land, to him and his Heirs for ever, or a Lodging only for a Week; or whether it be barely traveling freely on the Highway... (Locke, 1960:Section 119, p.348).

Epstein (1985) counters that assertions as strong as this one of Locke's require actual and contractual consent, not merely the hypothetical "tacit" consent suggested; and, actual consent could not genuinely take place with large numbers of people, given the ubiquitous problems of market failure. Epstein suggests that a better theory would develop and protect individual liberty within the context of *just compensation*:

> Now it is that whenever any portion of [his property] is taken from him, he must receive from the state (that is, from the persons who take it) some equivalent or greater benefit as part of the same transaction...There is no contract as such, only a network of forced transactions designed to leave everyone better off than before. (Epstein,1985:15).

This suits the thrust of Locke's property rights philosophy as well. Locke goes on to admonish mainly that those takings by the government be "only for the Publick good" (Locke 1960:268). Note from this especially, that there can be no doubt that Locke recognized that some cases of takings would be legitimate.

Warm Glow Altruism

In his essay, "Gifts and Exchanges," Arrow (1975) speculated that there are several alternative classes of motivations for making donations, of which he identified three:

> 1. The welfare of each individual will depend both on his own satisfaction and on the satisfaction obtained by others.
>
> 2. The welfare of each individual depends not only on the utilities of himself and others but also on his contributions to the utilities of others.
>
> 3. Each individual is...motivated by purely egoistic satisfaction derived from the goods accruing to him, but there is an implicit social contract such that each performs duties for the other in a way calculated to enhance the satisfaction of all. (Arrow,1975:17).

The first of these has been called a form of altruism, and it is commonly specified so that the potential donor's utility function is of the form, $U=f(D,X)$ where X describes the vector of goods and services consumed directly by the donor, and D describes the community total of the donated good, from which the donor also receives utility. Consistent with the focal issue of this paper, I will assume that *D* is a public good.

Altruism of this type, however, has drawbacks for the present purpose; it has been pointed out that under this model, free riding behavior would be complete. Hoping that others will provide for the public good, each potential donor becomes a "free rider". The drawback to the theory is that free riding, predicted to be complete in this theory, is seldom complete in the real world; that is, the theory in this form is commonly wrong.

Steinberg (1987) proposed that as an improvement we reconsider Arrow's second category of motivation, that donors also receive utility directly from the act of giving. By example, the implication is that when we nurture our children, feed our pets, care for our friends, water our plants and so on, we also get a benefit by reflection: A "warm glow". Andreoni (1990) used this phrase in describing the "gift of giving." He went on to study the many related incentives for giving, and he identified those cases where the utility function takes the form $U=U(D,X,d)$ (the donor's own contribution represented by d), as cases of "impure altruism". Both giver and receiver gain in utility from the gift. This version, it seems, was described exactly by Shakespeare's character, Portia: "the quality of mercy is twice blessed, ... it blesseth him that gives and him that receives."

The essential facet of giving relevant to this paper is that it provide utility to the giver as well as to the receiver, whether it be through a warm glow or through some other utility-enhancing pathway. The second essential fact of giving needed here is that the donation be to a public good.

Mark Pauly's Efficiency Rationale

The warmest glow from giving surely comes from seeing the improved health of the people we know best, but in principle the idea extends to anyone with whom we can identify. Within a family, such external benefits are sufficiently internalized and free rider behavior is easily disciplined; this might even be true for some communities. But, the gift-giving sentiment of impure altruism, can be strong even for a distant stranger whose story is colorful and captures our attention: A little girl who falls into a deep well in far-off Texas can have most Americans holding their breath and watching for each day's news.

Many people of course may feel neither a warm glow nor any utility gain from giving, but this fact need not inhibit collective action. As Pauly (1971:10-11) put it:

> The desire to eliminate the diseconomy that the presence of curable but uncured disease or injury may exert on others does appear, in general terms, to be a common characteristic of human beings. At least at some levels, most of us would be willing to give up some of our income to help a suffering fellow. Some may, of course, be immune to such feelings, but individuals may also be immune to contagious disease, and this should cause no insurmountable theoretical problems.

When external benefits exist but are not internalized by the private market, the market output will fall below the optimal point for society. This makes a *prima facie* economic efficiency case for social health insurance.

Mancur Olson on When and Why Markets Fail

Olson's (1965) discussion of market failure and the free rider serves as a prime source for further needed concepts. Were the total benefits to individuals from a planned public project to exceed its total cost it is nevertheless plausible that the project will not be funded. *All* people who benefit may choose to free ride, that is, to refuse to contribute, each depending on the others to pay and each realizing that they cannot in any case be excluded from the benefits. The state's power to tax provides a mechanism through which to elicit general compliance, and thus can permit the external benefits to be reaped.

It is useful further to recall the logic of Olson's analysis of group behavior. The analysis poses two important issues for the present case, those of group size and of the size of the largest group member.

Since SHI must cover a large population, the group size will be large. Small groups, for example, families or clubs, have a better chance of overcoming the free rider, but, in large groups, the problem can be severe. The fraction of benefits going to any one person is certain to be too small to justify that she would pay for the entire group. Conversely, there will be no individual in the group who is "large" enough to purchase the public good outright. Private charities who adopt the mission to provide health care to the uninsured, would face a severe problem of free riders. As Olson further showed, were a quantity of the public good to be privately provided, it would be provided sub-optimally.

Why Ronald Coase's Solution Won't Work

This case for SHI, based as it is on the prospect of market failures in charity markets, would be upended if the Coase Theorem were to apply. Chicago economist, Ronald Coase, demonstrated that externalities may be spontaneously internalized by market activities in some cases. The situation can be illustrated by the example of a farmer who waters his cattle downstream from a potentially polluting factory. Pollution, an instance of a detrimental market externality, is well known to destroy market efficiency unless the true costs of factory production--the production costs incurred by the factory owner plus the pollution costs incurred by the farmer--can all be internalized into the calculations faced by the factory. Coase's insight was that the two agents have the incentive to spontaneously join in a side market that restores market efficiency. The key assumptions required of the Coase Theorem are that 1) property rights are clearly established, and 2) the transaction costs, the costs of finding and arranging mutually agreeable trades, are virtually zero. Does this model apply to charity markets for health care, thus eliminating any need for collective action?

It is doubtful that these conditions apply. First, many charitable benefits of health care are difficult either to measure or to contract for; examples include the benefits to people living in pockets of poverty in distant cities, and the benefits of protecting against the uncertainties of employment and income. The sheer number of people would make the transactions costs prohibitive. To identify each relevant property right and to measure each external benefit would imply that transaction costs mount up imposing a formidable obstacle to efficiency in private charity (Dixit and Olson, 2000).

Governments Usually Fail, Or Do They?

Government agencies, which like private organizations are composed of many, varied people, are also likely to fail to be efficient. Personal incentives within government organizations are not regularly disciplined by market forces, and arguably they are less efficient than private enterprise. At least in theory.

While the theory often works, health care markets sometimes run counter to it. In hospital markets, for example, where public firms, private firms, and not-for-profit firms compete and face considerable market rigors, the economic frontier studies tend to report little or no efficiency difference (Folland and Hofler, 2001; Burgess and Wilson, 1998, 1996; Zuckerman, Hadley and Iezonni, 1994). Nursing home efficiency studies, though usually favoring the for-profit mode, tend to be less certain when the complexities of quality measurement are thoroughly addressed (Rosko et al, 1995; Fizel and Nunnikoven, 1992; Hofler and Rungeling, 1994; Gertler and Waldman, 1992; Gertler, 1989).

Regarding SHI directly, the Medicare experience provides the best case to study. The common concern, that Medicare's future might be disastrously costly, centers on 1) the changing population distribution, 2) the increasing average costliness of care for the elderly, and 3) the inefficiencies in its insurance provision. The first two issues are beyond our present scope, but the last is directly relevant; and the evidence, according to Cutler and Sheiner (1999), gives "substantial reason to doubt the efficiency of the current Medicare system". They find that the large geographic variations in Medicare expenditures between small areas across the United States represent a substantial potential for reform, though, no comparison with the private sector is offered.

Comparing the mixed U.S. system with the single-payer system of Canada provides another relevant test. A strong case can be made that the Canadians pay less for their health care, use fewer high tech input resources, and remain as healthy or healthier by the usual health status indices as Americans (OECD Health Data 1997, 1998; Rublee 1994). When regions of the United States and Canada, chosen to have similar demographics and ethnic homogeneity, are compared, the Canadians still spend substantially less (Fuchs and Hahn 1990). Administrative costs are substantially lower, and this includes much lower insurance administration costs (Woolhandler and Himmelstein 1991).

The same reasons for the lower Canadian expenditures, however, also warrant caution. Pauly (1993) compared U.S. data with that of other OECD countries and found that we pay top health care managers and medical personnel much more than do other developed countries. He simulated a comparison by "paying" U.S. health personnel only their opportunity costs (versus their much higher actual incomes) and found this procedure resulted in a lower U.S. expenditure per capita even into the middle of the pack of the 17 developed countries under consideration. A further caution is that the lower availability of high tech services in Canada than in the United States leads to longer waiting times. American health professionals living in large border cities have seen many Canadians seeking care in the United States.

Would SHI raise or lower the costs of health insurance provision in the United States? We have seen only that there are many complexities. We can add, however, that a SHI need not absorb the insurance function. It could instead provide only on the redistributive function. For example, the individual mandate plan (Pauly, Feldstein, Danzon, and Hoff; 1991) invokes collective action primarily to support those unable to purchase health insurance on their own.

Some Cautions

Though widely mentioned in policy literature, a few cautions should be made explicit. First, given that SHI issues are hotly disputed, we must acknowledge that any proposal made to Congress can lead to unpredictable results, conceivably even a worsening of health insurance coverage (Epstein, 1999). Second, unlike finances through private market activity, government finances itself through taxes, which inevitably distort productivity incentives. Estimates of the distortion range from modest estimates of around five percent of market revenue to many more recent studies suggesting much higher welfare losses. Finally, all restrictions placed on insurance industry property rights, whether by regulation, limits or takings, entails costs. Under the principles of proper legal procedures, these takings require just compensation.

II. Distinguishing This Approach From Other Views

Other Theories Based on Self-Interest: Philosopher Allen Buchanan (1984) also described a rationale for SHI that can be seen as based on the beneficial externalities principle, though his view was not fully elaborated. The commonality is that he describes the motive of those who would donate to the health of others as doing so out of self-interest. Buchanan's idea could be understood as a form of the "impure altruism" concept described later by Andreoni (1990).

Other theories of SHI based on self-interest, such as Churchill (1994), apply the ethical concept of reciprocity. In that context, one might support a SHI plan based on the ethic that 'this time it is you that needs help but next time it might be me'. Churchill elaborates his reciprocity argument by basing it on the writings of David Hume. The point of society, in this view, is to provide for solidarity and security. SHI benefits people in Hume's society by both providing health insurance but also by insuring people against unexpected declines in personal income, which can otherwise destroy the means to pay for emergency health care. SHI thus provides a mutual advantage, a reciprocal generosity.

The Right to Health Approach

Self-interest arguments contrast most sharply with the "right to health" approach. Using the term "right" often causes confusion, because it is applied in various ways. A right can be negative implying a claim to *freedom from*, such as freedom from an unlawful entry of one's home. A right can also be positive, entitling, for example, a person to a specified level of health care when he is sick or to be rescued from a debilitating condition. Such rights as these may be asserted to have a solid philosophical basis, and, in consequence, they may be said to exist independently of any legal status. However, when rights are written into law they become "legal rights", which term may or may not convey a deeper moral imperative. People commonly use the term *right* to insert an extra sense of moral force behind the proposition being advocated. An ethical theory that asserts that ethical propositions amount to little else but a way of adding emotional emphasis and force to one's preferred policies is called emotive ethics theory.

Rights language naturally provokes caution among economists, especially when it is inserted into otherwise positive analysis. When "rights" are maintained hard and fast, they often will result in economic inefficiencies, because they can prohibit tradeoffs between the specially favored use of resources and other more productive uses. In the extreme, competing interests may come to be discarded. The individual's *right to a basic minimum*, as derived from Rawls' (1971), or simply a society's determination that *health is special*, as in Daniels' (1985) model, are each good examples both as well developed rights theories and as examples of the risks of rights theories to economic efficiency.

John Rawls: In the *Theory of Justice*, Rawls' "veil of ignorance" provided a neutral platform from which to assess the fairness of a given distribution of resources. We position ourselves as if prior to our own birth, before the earthly realization of ourselves installs in us many vested interests. Behind the veil, we would realize that we could become the worst off person in society. Rawls argued that thus thinking more fairly we would take great care to guarantee a satisfactory outcome for whomever actually became the worst off. He said that behind the veil one would distinguish between distributions by preferring the one which gives the greater income to that person who is worst off. Only in such a context would we realize a system of "justice as fairness".

Rawls' society would curtail many former freedoms for those presently well-off, but he claimed that such a structure preserves true liberty. On its technical terms, Rawls has us join into society through an initial, voluntary, and unanimous choosing, and in this respect it is similar to that of Locke or of Buchanan and Tullock.

The major criticism of his view comes from writers who find his imagined choice behind the veil to be implausible: Would people so situated really be so risk averse?

Would we so fear extreme illness in our prospective existence that we would pre-commit that virtually all resources of society might need to be made available to the most ill person? Arrow's (1975) criticism makes the point succinctly:

> Thus there could easily exist medical procedures which serve to keep people barely alive but with little satisfaction and which are yet so expensive as to reduce the rest of the population to poverty (p. 251).

Norman Daniels (1985): Daniels' also claims a right to health, though he bases it on the specialness of health. Health has a unique and essential role in life because it enables a "species-normal functioning" to which everyone is entitled. We all deserve to have a range of behavior available to us, this gives us a *fair equality of opportunity*. While there is no guaranty that the people will experience an equal distribution of skills and talents, everyone is entitled to sufficient good health. Health is special.

The fair equality of opportunity version of the right to health, however, is criticized on similar grounds as the criticisms of Rawls' justice as fairness. If we accept that 1) health is special, and 2) it must be able to draw resources at top priority, we must question whether this right would not generate severe inefficiencies in society or even create a bottomless pit for society's resources.

Opposing SHI on Modern Libertarian Grounds:

Robert Nozick: The late libertarian philosopher, Robert Nozick, in *Anarchy, State and Utopia* (1974), began as I have from a Lockean basis, but he reached a very different result; he denied the legitimacy of providing any programs such as SHI in the liberal state.

Nozick justified the liberal state itself as a Pareto improvement over an anarchic existence of a people who live in a dangerous milieu with "competing police forces". The tribes inevitably experience attacks from other tribes, and they protect themselves by hiring defenses. These tribal police forces, however, may add to the collateral damage as they fight among themselves. There are thus clear advantages available through establishing a state monopoly police force. The social benefits, he argues, are likely to be sufficient to generate voluntary compliance, because any person harmed by the transition can be given sufficient compensation so that he prefers the transition from the status quo, this compensation Nozick describes as *just compensation*.

But, what exactly are these benefits? Consider a modern example. If police protect several houses on a city block, the remaining houses become harder to access by criminals. This is an external benefit created by the availability of police generally. Nozick, in discussing the nature of the gains created by the state, recognized these kinds of gains, the capturing of external benefits and the provision of public goods.

While often not mentioned by name, these economic concepts are central to Nozick's theory of why a libertarian state is preferable to anarchy. At a crucial point, the state abrogates police power to itself; what then justifies both the rejection of the markets for private, competing police forces as well as private compensations for violations of another's property rights? In this passage, Nozick identifies the problem as the side effects caused by such crimes, in particular the widespread fear provoked in people not themselves direct victims:

> ... in these cases it will be almost impossible to determine accurately what is the amount of market compensation, except by actually going through the negotiation. Our argument in prohibiting certain actions, such as assaults, assumes that merely to require an attacker to compensate his victims for the effects of the attack ... would not sufficiently deter attacks so as to leave people unfearful. (Nozick, 1974:68-69)

He leaves no doubt that, when there is widespread fear of violence, market-type compensation fails, and this failure justifies the major role for the state. Nozick, who was well aware of the Coase Theorem, couched his argument so that the question of whether transactions costs are prohibitive becomes the focus point.

> Even under the strongest compensation proposal which compensates victims for their fear, some people (the nonvictims) will not be compensated for their fear. Therefore there is a legitimate public interest in eliminating these border-crossing acts, especially because their commission raises everyone's fear of its happening to them. (Nozick, 1974:67).

He further realizes that independents, police forces uncontrolled by the state, have to be prohibited. Could all independents join in a voluntary agreement for the purpose of controlling the damaging side effects? In again arguing for the state at this step, Nozick invokes the free rider concept:

> The problem is, that if a large number of independents do this, it will be in the interests of an individual to abstain from this purpose. (Nozick, 1974:89).

Finally, he invokes economies of large scale policing to further promote the monopolization of policing by the state:

> [Where policing is not fully monopolized by the state] the clients of [the partly monopolized state] protective agency then must compensate the independents for the disadvantages imposed upon them by being prohibited

> self-help enforcement of their own rights...Undoubtedly, the least expensive way to compensate the independents would be to *supply* them with protective services... (Nozick, 1974:110).

I propose that Nozick sustains these arguments that show the superiority of the state to anarchy but that he does so by invoking essentially the same reasoning as that of mainstream economics. The gains or losses from collective action in both depend on either the existence of external benefits or the elimination of external costs. Surely he is right, we reap gains from beneficial externalities in the step from anarchy to state, and just as well there may be economies of scale and scope. My point, however, is that the capture of beneficial externalities, the lift that elevates Nozick's libertarian state above anarchy, is the same as that which could elevate many other collective actions over the private market alternatives. Understood this way, Nozick is right to find the state preferable to anarchy for free persons, but he did not recognize that other collective actions would also qualify as net gains for free citizens.

This content in Nozick has not gone unnoticed by those libertarian writers who share Nozick's distaste for collective action. Philosopher and historian, Jan Narveson, asks for example:

> Is there something special about protection that makes it peculiarly eligible for relegating to a central agency?...[Nozick's] argument is of a type that would, if it works at all, will surely be able to establish the legitimacy of an equally state-like apparatus for other functions, contrary to Nozick's explicit intentions. (Narveson, 1988:288).

Richard Epstein: Modern libertarian legal theorist, Richard Epstein (1999) criticizes indirectly several of the features in the theory I present in this paper, making three arguments in particular. First, he argues that private charity is sufficient to correct for the market failures in health care markets. He claims that such "...institutions ...have long been able to nudge [potential donors] along that path...".

Observers generally report, however, that free rider behavior is common, and to some extent this claim can be quantified. A recent study by A. Abigail Payne (1999) finds partial crowding out to be about 50 cents in reduced total charitable services for each dollar increase in government contribution. This means that if government charity expenditures were reduced by a dollar, private charity would rise by only 50 cents of the gap so created. It is true that we cannot determine from this whether private charity is 'insufficient', it is hard to identify what 'insufficient' means. But, at least we can conclude that private charity in this case is likely to be far less than its collective counterpart.

Epstein's second objection is that the externalities and public goods reasoning "presupposes an odd motivation for charitable activity...I doubt that many people think of charitable efforts as being on a par with courts and police protection" (p. 38). However, economic theory applies easily to other cases of beneficial externalities and public goods that are as different from police protection as is social health insurance: For example, public support for vaccinations, public schools, and environmental pollution problems.

Finally, he argues that the coordination of charitable giving can be handled without government action: "Corralling the reluctant [well-to-do potentially donating] parties can be done, moreover, without enormous complication by allowing charitable deductions for charitable goods and services, a mechanism that has long been in place under the tax laws" (p. 39). However, this approach merely changes incentives by degree. The free rider, who pays nothing anyway, has no change in price. Perhaps some perceive donating to become attractive at some price. But, the large majority to begin with are free riders and might well free ride at any price. We recall that in Mancur Olson's theory, free riding *is* complete at any price. Neither does this method reduce the transactions costs of coordinating large numbers of charitable people to jointly contribute.

Epstein makes a more telling argument, however, and one that addresses virtually all introductions of government programs. What is designed on paper will not be what is derived by Congress in practice. "The decisive test is not how a system of rights fares when the seas are calm: it is how that system fares when the seas become choppy" (Epstein 1999, p. 47). The bills that are presented to Congress will not be the bills that it passes, the program thus designed will not be the program put into practice.

III. What Would Locke, Smith, Mill and Hayek Do?

The following argues that the leading writers of the classical liberal tradition plausibly would support a universal social health insurance if they were alive today. For this purpose, I choose Locke, Smith, Mill and Hayek, respected economic philosophers who are often cited as the central intellectual figures of the libertarian tradition (Wolfson, 2004). Of these, only Hayek spoke directly of "social insurance"; however, I will attempt to show that each of them: 1) valued charity and community very highly; 2) understood that property rights can be traded off for other gains, including the good of the community; and 3) understood, each within his historical context, the economic rationale for market intervention based on the existence of beneficial externalities and public goods.

John Locke

Locke wrote from deeply religious beliefs, even his famous argument against the divine right of kings was designed to show that monarchy could not be derived from biblical teachings, which teachings he assumed to be true without doubt. Locke derived the principle of property rights from natural law theory. One is entitled to his body, and he also takes property in what he earns from nature through his labor. One mistakes Locke, however, were he taken to claim that property rights are perfectly inviolable, nor is it correct to say that they constitute absolute constraints against collective actions that would benefit the community. To the contrary, Locke qualifies these rights in unmistakable language:

> The same law of nature that [gives us] Property does also *bound* that property too...As much as anyone can make use of any advantage of life before it spoils; so much he may by his labor fix a Property in. Whatever is beyond this, is more than his share, and belongs to others.(Locke, 1960:T II, 31).

In the First Treatise, he even finds charity to be an obligation of the individual:

> God the Lord and Father of all, has given no one of his Children such a Property in his peculiar Portion of the things of this World, but that he has given his needy Brother a Right to the Surplusage of his Goods; ... *Justice* gives every Man a Title to the product of his honest Industry,

> and the Fair Acquisitions of his Ancestors descended to him; so *Charity* gives every Man a Title to so much out of another's Plenty, as will keep him from extream want. (Locke, T I, 42, p. 170).

In Locke, it is the Law of Nature, which obliges everyone, and "...that Law teaches all Mankind ... that being equal and independent, no one ought to harm another in his Life, Health, Liberty, or Possessions," (T II, ii, 6) ...but it places us under a positive obligation to promote the Preservation of all Mankind (T II, ii, 6-8). It is further clear that Locke considered that government may have a legitimate role in this effort, because he was a supporter of revisions to the English Poor Laws that would increase governmental succor to the poor. Locke said in that regard:

> every one must have meat, drink, clothing, and firing. So much goes out of the stock of the Kingdom, whether they work or no (Locke, 1697:4).

Locke's support of public involvement in charity can be seen as consistent with his strong support of property rights in the context of the present day theories I have described. Impure altruism theory encapsulates his public charity interpreted as a rational response to a presumed substantial prevalence of beneficial feeling.

Locke, furthermore, in no way conceived man as atomistic or hyper-individualistic; far from promoting an isolated individualism, he understood the commitment of the individual to society as being strong and natural:

> God having made Man such a Creature, that, in his own Judgment, it was not good for him to be alone, put him under strong Obligations of Necessity, Convenience, and Inclination to drive him into Society, as well fitted him with the Understanding and Language to continue and enjoy it (Locke,1960:318).

He understood that to join a society requires man to trade off some personal liberties but he believed that the benefits of civil society made this well worthwhile:

> Where-ever therefore any number of Men are so united into one Society, as to quit every one his Executive Power of the Law of Nature, and to resign it to the Publick, there and there only is a *Political, or Civil Society (*Locke,1960:*325).*

Can private property be taxed to promote the public good? Certainly, Locke puts up formidable barriers on the methods of taxation: "[Governments] can never have a power to take to themselves the whole or any part of the Subject's property, without their own consent" (Locke, 139, p. 361). Yet, by distinguishing *improper* taxation he implicitly described *proper* taxation. Thus, when he says that government "must not raise taxes on the Property of the People, without the consent of the People, given by themselves or their Deputies" (Locke 1960:363), he implicitly states that taxation *with* representation is proper and that the approval of a new tax by representatives constitutes consent. The legitimacy of government in Locke extends to the broad purpose of promoting the public good:

> The Commonwealth seems to me a society of men constituted only for procuring and preserving their own *civil interests* (*bona civilia*) (Locke, Epistola de Tolerantia, (Locke, 2002).

Bona civilia is defined to include well-being in life, liberty, health and in the offsetting of indolence of body, not just the possessions of physical property.

Adam Smith

Smith is sometimes popularly described as the chief architect of a "harsh" laissez faire economic doctrine and even the champion of greed; however, economists, many of whom have read Smith in the original, know that he presents a more complex, rich, and even warm picture (Rothschild, 2001). Best known for advocating free trade unfettered by harmful governmental controls, it is less widely known that Smith was a sharp critic of the greedy merchants and manufacturers of his day. The term "greed" most often occurs in *Wealth of Nations* not as a virtue but as crude animal vice tamed only by the rule of law. Smith warns of the merchants:

> ...merchants and manufacturers...naturally endeavor to obtain against all their countrymen the same exclusive privilege which they generally possess against the inhabitants of their respective towns... which secure them the monopoly of the home market. (Smith, 1976:484).

And,

> But the mean rapacity, the monopolizing spirit of merchants and manufacturers, who neither are nor ought to be the rulers of mankind, though it cannot perhaps be corrected may very easily be prevented...(Smith 1976:519).

Smith saw in taxation a natural and needed means to finance public institutions; he promoted fair methods of tax collection, especially the principle that taxes be levied close to the population that benefited. Tolls fit this description, but, in Smith's view, so do most sources of taxation:

> The private revenue of individuals, it has been shown in the first book of this Inquiry, arises ultimately from three different sources:

> Rent, Profit, and Wages. Every tax must finally be paid from some one or other of those three different sorts of revenue, or from all of them indifferently (Smith, 1976:ii349).

Anticipating modern economics, Smith explained the role as well as the need for collective action through government:

> THE third and last duty of the sovereign or commonwealth is that of erecting and maintaining those public institutions and those public works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense to any individual or small number of individuals, and which it therefore cannot be expected that any individual or small number of individuals should erect or maintain (Smith 1976:ii244).

His analysis of public education anticipates that modern economic rationale for education which emphasizes the many potential beneficial externalities of having a better educated citizenry. Smith distinguishes between the education of the sons of the well-to-do and the sons of the working man. He promotes market solutions in the former case, ideas that would revolutionize much of higher education even today; let college teachers collect their fees from those students willing to pay them, he says.

In contrast, Smith proposed that public institutions provide education to the children of the working class; the reasoning he relates is much less a concern for equity than a concern for the broader benefit to society of having an educated polity. Here he is promoting public education and warning of the danger to society should the working man's mind be left uneducated.

> The man whose whole life is spent in performing a few simple operations...has no occasion to exert his understanding...The torpor of his mind renders him not only incapable of relishing or bearing a part in any rational conversation nor of conceiving any generous, noble, or tender sentiment...Of the great and extensive interests of he country his is altogether incapable of judging; and unless very particular pains have been taken to render him otherwise, he is equally incapable of defending his country in war. (Smith, 1976:III,II, 303)

Smith further distinguishes those people who society has encouraged into tasks which naturally limit their broader learning. When this occurs, public education may need to be provided; again, the collective action is needed not merely for the direct benefit to those educated but also for the side benefits brings to the state, that is, Smith identifies in this case the side benefit of the moral improvement of those that society and the economy have encouraged or shunted into tasks that limit them. This improvement removes a danger to society at large:

> In [some] cases that state of society does put the greater part of individuals in such situation, and some attention of government is necessary in order to prevent the almost dire corruption and degeneracy of the great body of the public. (Smith, 1976:III, Art II, p. 302).

Would not the Smith, who justifies a public education for the working man based on side benefits to society, also recognize that a modern day plan for universal social health insurance might offer side benefits as well?

John Stuart Mill

Any account of the work of preeminent writers in the liberal tradition must include John Stuart Mill, as would any list of the best writers of economic prose. Mill qualifies his defense of liberty in a manner, like Smith, that also prefigures modern economic theory:

> ...one very simple principle, as entitled to govern absolutely the dealings of society with the individual in the way of compulsion and control...is, that the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their member, is self-protection...The only part of the conduct of any one, for which he is amenable to society, is that which concerns others. (Mill,1975:11).

And,

> As soon as any part of a person's conduct affects prejudicially the interests of others, society has jurisdiction over it. (Mill 1975:70).

We can surmise that Mill's dictum would encompass both direct harms to others but also recognize harmful side effects of activities aimed at some other purpose. Does this reveal Mill to acknowledge the *beneficial* externality principle?

First, let us acknowledge that Mill promoted community-mindedness and generosity, at least were given freely. He says:

> It would be a great misunderstanding of this doctrine to suppose that it is one of selfish indifference, which pretends that human beings have no business with each other's conduct in life ... Instead of any diminution, there is a need of a great increase of disinterested exertion to promote the good of others (Mill, 1975:70-71)

But, would Mill allow a role for government based on beneficial externalities in the public provision of health insurance? We will not find a direct answer to this question, because Mill wrote a century and a half ago; but it is clear that Mill took a utilitarian view of even his libertarian ethics, that is, he believed in the logic of tradeoffs in social policy:

> I regard utility as the ultimate appeal on all ethical questions; but it must be utility in the largest, sense, grounded on the permanent interests of man a progressive being. Those interests, I contend, authorize the subjection of individual spontaneity to external control only in respect to those actions of each, which concern the interests of other people (Mill, 1975:12).

The change in terminology here, from talk of detriment to others to the phrase "..interests of other people," is consistent with his utilitarian way of reasoning. Given that background, it is safe to infer that "others" described here might either be benefited or harmed by the action for the action to qualify. The power he allows, the "subjection of individual spontaneity", appears to be more coercive power than we would need or perhaps want in the context of this paper, but it clearly shows that Mill has a broader ethic than is initially apparent.

Would Mill permit the coercive state powers needed to collect taxes? He leaves no doubt on this matter:

> ... it must be remembered that taxation for fiscal purposes is absolutely inevitable that in most countries it is necessary that a considerable part of the taxation should be indirect; that the state, therefore, cannot help imposing penalties, which to some persons may be prohibitory, on the use of some articles of consumption.(Mill, 1975:93).

Mill goes on to speak approvingly of taxes on stimulants, a view seemingly at odds with a libertarian philosophy. The main point at issue, however, is clear. Mill had no objection to the power of the states to levy taxes.

Friedrich Hayek

Though there are many twentieth century spokesmen in the classical liberal tradition, the Austrian economist and Nobel Prize winner Friedrich von Hayek stands out both as an heir to the liberals as well as a writer of considerable clarity. Hayek was once popularly criticized as an extreme or arch right antisocialist during the years when American excesses in anticommunism were commonplace. Despite the former popular perception of his views, his writing was always thoughtful, and it is no surprise that his frequent adversary on many issues, John Maynard Keynes, admired Hayek's work greatly.

Hayek defined one's degree of freedom by the answer to the question: Can the person expect to shape his own course of action in line with his intentions? Fundamental throughout his *Constitution of Liberty*, substantial benefits to society are to be found in the encouragement of personal freedoms. He speculated even that freedom permits greater variation in human experience and that this variation increases the number of natural experiments and beneficial accidents. Hayek's view of mankind is a humbling one; we owe human progress primarily to accidents and unanticipated discoveries.

Nevertheless he saw no *a priori* bar to collective action and thought social health insurance would bring net benefits to society. Consider Hayek's views of the earlier sages, Locke, Hume, Burke and Smith each of whom he admired:

> their argument was never a complete laissez faire argument...In fact their argument was never anti-state as such or anarchistic, which is the logical outcome of the rationalistic laissez faire doctrine; it was an argument that accounted for both the proper functions of the state and for the limits of state action (Hayek, 1960:60).

Far from envisioning a society of separate, human "atoms", Hayek believed that concern for others is a most beneficial and prevalent characteristic of men and women:

> It is part of the ordinary nature of men (and perhaps still more of women) and one of the main conditions of their happiness that they make the welfare of other people their chief aim...By common opinion our chief concern in this respect should, of course, be the welfare of our family. But we also show our appreciation and approval of others by making them our friends and their aims ours...[Though] it is one of the fundamental rights and duties of a free man to decide what and whose needs appear to him most important. (Hayek, 1960:78-9).

This paragraph summarizes well the role of charitable action in the liberal state. Programs providing benefits broadly to the public, including charity may qualify for collective action, provided that the citizen donor has a proper say for whom and how the benefits are to be provided. Hayek's philosophy provides that the majority rules subject to its adherence to the constitutional framework:

> The democratic and liberal traditions thus agree that whenever state action is required, and particularly whenever coercive rules have to be laid down, the decision ought to be made by the majority...[However] the liberal believes that there are definite limits to the range of questions that should be thus decided...The authority of democratic decision rests on its being made by the majority of a community which is held together by certain beliefs common to most members." (Hayek, 1960:106)

A century earlier, Mill had distinguished between "good taxes" and "bad taxes," and in similar fashion, Hayek described how taxes can be designed to limit their coercive effect:

> Though these are not supposed to be avoidable, they are at least predictable and are enforced irrespective of how the individual would otherwise employ his energies; this deprives them largely of the evil nature of coercion....Where such coercion is necessary even in a free society, as when we are called to serve on a jury or to act as special constables, we mitigate the effects by not allowing any person to possess arbitrary power of coercion. (Hayek, 1960:143).

Among the writers I consider here, only Hayek was a contemporary of Social Security and thus could comment on its role as well as on the prospect of social health insurance, he said:

> Up to this point the justification for the whole apparatus of "social security" can probably be accepted by the most consistent defenders of liberty. Though many may think it unwise to go so far, it cannot be said that this would be in conflict with the principles we have stated." (Hayek, 1960:286).

And, to social health insurance as a special case:

> There is little doubt that the growth of health insurance is a desirable development. And perhaps there is also a case for making it compulsory since many who could thus provide for themselves might otherwise become a public charge. But there are strong arguments against a single scheme of state insurance; and there seems to be an overwhelming case against free health service for all." (Hayek, 1960:298).

Hayek here is open to endorsement of SHI in these paragraphs, which will seem remarkable to many who are familiar with him only by reputation. That he rejects a single-payer system as well as a zero-price subsidies to all is consistent with both his respect for property rights and his understanding of economic efficiency. We are left with no doubt, however, that he saw that an SHI plan could be designed in principle so as to be congenial to a liberal state.

IV. Implications for the Modern Debate

Comparing the SHI Plans

The typical social health insurance proposals--single payer, employer mandate, and individual mandate—are rightly compared on grounds of efficiency and equity but also, in a liberal-minded state, they ought to be compared for their effects on property rights. To simplify the discussion, let us assume that each plan to be considered covers the population universally and offers at least a decent minimum of health care coverage. In making this assumption, let us stipulate that each plan adequately meets the equity criterion, reducing of our present focus to efficiency and liberty.

Single Payer: A conversion to a single payer system could arguably reduce total system administrative costs. It would also eliminate the remaining obstacles to worker mobility. By increasing total coverage, total cost of care would increase, though this much added cost could be an experience common to all the plans. A distinction needs to be made when assessing the incremental costs of a SHI, one which is especially important for the single payer method: The increment to the government budget as distinct from the increment to total health system. The single payer plan, by absorbing the insurance function into the government budget would create the largest increment to the government budget. Routing the greater portion of expenditures into the government budget, it would thus also cause the greatest tax distortion effect of the three plans. It would also create the largest one time cost of system conversion. The single payer plan would cause the greatest intrusion on property rights of these three plans, in each other alternative considered here, the insurance industry remains intact. Although the insurance companies are sometimes publicly regarded as culpable for health systems problems, those claims are probably exaggerated and in any case are unlikely to justify appropriation within a proper legal context of takings. And, if on the contrary, they were found to be justified in court, then the takings would require compensation.

Employer Mandate: Such a plan might require all employers to provide a decent minimum health insurance to their employees, with governmental assistance provided to small firms and to the unemployed. The main incremental health system costs stem from the increased consumption of the formerly uninsured. The incremental governmental budget would be much smaller than in the single payer system, it incurs costs to cover workers in small firms and the unemployed and to administer the system. The plan, however, tends to make permanent the attachment of health insurance to the employer and thus would preserve some obstacles to employee mobility. Further, the extra cost of the insurance will likely fall largely on the employee; this incidence pattern, though not yet firmly established by health economic research, it is consistent with findings from labor economics and is widely assumed to be true by health economists. Nevertheless, it is commonly believed among the public that the burden falls mainly on the firm; and this confusion could cause the burden on employees to go unappreciated by the public at large.

To the extent that the plan is designed to have any effect on the health insurance industry (the Clinton Plan, for example had the potential for significant effects), there will be takings of property rights, though these will be smaller than the single payer system. Where the incidence of the employer mandate falls on the employee through lowered wages, the employee loses some consumer freedom.

Individual Mandate: The individual mandate plan requires each person to hold an approved health insurance plan, one offering a decent minimum of coverage. Those who take health insurance through work could continue to do so. The poor, including many of the uninsured, would receive financial assistance to purchase insurance. The main increment to health system costs stems from the increased expenditures of the formerly uninsured, the target of the program. The increment to the government budget would be limited to providing the subsidy and monitoring the program.

The individual mandate, by compelling everyone to purchase a plan, coerces some persons to insure who otherwise would not. Individuals are free, however, to choose from any qualifying plan offered. An addendum to the proposal could be, but need not be, to amend tax law so that all people get the same tax treatment as individuals that they do through fringe benefits at work. The result of such an addendum would be to remove any remaining obstacles to worker mobility. Since most Americans are insured already, the individual mandate would have the fewest consequences for property rights among the three plan types.

So Which Plan Is Best?

These plans, of course, are hotly contested, and the sketch of those of their characteristics that are unrelated to the present issue cannot do justice to the full debate. My point is that the addition of the liberalism criterion to the analysis provides a richer view. Are American analysts and stakeholders unaware of its importance to their debates of the role of takings? Of course not. In virtually all policy debates where takings are at issue, they are at the center of the storm. My reading of the literature, however, is that the role of our country's shared tradition of liberalism is often downplayed or even omitted in health policy or health economic discussions that compare SHI plans.

Conclusion

Social health insurance can be supported from many viewpoints; from several of these alternative perspectives a justification consistent with Locke may be unnecessary. Yet, it would be a misreading of our history and culture to insist that it simply does not matter. In Fabian or Marxian socialism, private property has either no legitimacy or weaker legitimacy than in Locke. In these cases, welfare is conceived as a central purpose of the state; the provision of social health insurance is correspondingly a natural function of the state. In these cases, perhaps liberal tenets are not central. Other modern arguments follow President Franklin Roosevelt's reasonings and combine a strong presumption of the value of liberty with a strong presumption of the need to help others. Correspondingly, these showed a greater willingness to trade off individual liberties than would be seen in Locke. In Roosevelt's philosophy, the preservation of individual liberties was defined so as to include the freedom from want; and when the two types of freedom conflicted a substantial weight was given to the freedom from want.

Each of these philosophical and economic positions reaches social health insurance via a different route, and with different emphases. Nevertheless, the classical liberal and the modern U.S. liberal share commonalities: Both, respect, to different degrees or in different ways, the motive to preserve individual liberties. Both respect the Constitutional liberties generally: Free elections, free speech, freedom of the press and so on. I have shown, however, that the traditional liberal sages also recognized a moral obligation to assist those in need. And, as I have attempted to show, both consider collective action to be a potentially acceptable means to do so.

In summary, collective action to provide social health insurance could be designed to resonate with the philosophy of a charitable liberal state. Whether a given person should vote for such a plan is beyond the scope of this paper. The present inquiry is focused directly only on clarifying a common misunderstanding that the traditional libertarian-minded philosopher must necessarily be identified with those more narrow writers who oppose collective action generally. To the contrary, traditional liberalism would likely find a well-crafted social health insurance program to be philosophically agreeable.

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