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A Principal-Agent Analysis of the Family: Implications for the Welfare State

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ABSTRACT: The principal-agent literature has focussed on situations where both principal and agent are assumed to be capable of defining and defending their own interests. The principal-agent literature has thus ignored an important set of cases where the principal is incapable of acting on her own behalf, and so is assigned an agent by law or custom. Such cases account for around 40% of humanity and for a similarly substantial proportion of all principal-agent interactions. This paper applies principal-agent analysis to one such case, the family, where the child is taken as the principal and the parent is her agent. The principal-agent problem within families creates a *prima facie* case for state interventions to protect child-principals, since some parents will shirk and the consequences of such shirking may be serious and irreversible damage to the child-principal, who cannot defend herself. The principal-agent perspective on the family sheds new light on two old debates: about whether state welfare services should be provided in cash or in kind, and about user fees for social services involving children.

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1. Introduction

Principal-agent (P-A) analysis has emerged as a popular and useful tool in the social sciences since the early 1970s, especially in accounting, finance, economics, management and organisation theory. The literature has, however, confined its attention to a sub-set of P-A problems, namely those of a commercial-economic-managerial variety and those in and around the public bureaucracy. The usefulness of the P-A heuristic in analysing the family has been greatly underestimated. I will argue that an analysis of principal-agent interactions within the family is essential for understanding the legitimate roles of the state and family in welfare provision. This is because the family represents a special case where the principal, the child, is incapable or only very imperfectly capable of defining and defending her interests and imposing them on her agent, the parent, and so is assigned an agent by law or custom. I will further argue that the potential for P-A conflicts within the family creates a *prima facie* case for certain types of state intervention in family life in order to protect children's rights and welfare. A P-A analysis of the family also argues for provision of some state welfare services in kind rather than in cash, and argues against user fees for basic social services involving children.

2. Principal-Agent Problems: An Overview of the Literature

A principal-agent "relationship has arisen between two (or more) parties when one, designated as the agent, acts for, on behalf of, or as representative for the other, designated the principal, in a particular domain of decision problems" (ROSS [1973, 134]). In the P-A literature, the agent is empowered to act for the principal because the principal chooses to hire the agent or because there is an implicit contract between principal and agent. The P-A problem lies in the fact that differences of interest and information between the two parties mean that the agent may not always act in the interests of the principal, and the costs and difficulties of selecting an agent and monitoring his performance mean that the principal may not be able to enforce her will on the

agent. Typical P-A interactions mentioned in the literature include those in the commercial-economic-managerial realm (e.g. shareholders and company managers, managers and employees, landlords and sharecroppers, clients and professionals, insurance companies and policy holders) and those in the political-bureaucratic realm (e.g. citizens and elected officials, the legislature and the bureaucracy, the government and regulated public utilities) (e.g. BOWIE and FREEMAN [1992a]; MOE [1984]; MULLIGAN [1997]; PETERSEN [1995]; PRATT and ZECKHAUSER [1985a]; STIGLITZ [1987]; ZAJAC [1995]).

Barry MITNICK [1992: 76] has traced the origins of recent P-A analysis to three schools of thought: the risk and information or decision theoretic literature, the economic theory of the firm, and the sociological or organizational social science literature. He might also have added a much older source, namely legal theories of agency and fiduciary relationships (BOWIE and FREEMAN [1992b]; CLARK [1985]; MUNRO [1987]). Scholars using P-A models are influenced by each of the above traditions in varying measures, which gives quite different flavours to the various strands of the P-A literature.

P-A literature following the risk and information or decision theoretic tradition has dominated discussion and modelling in the mainstream neo-classical economics journals. The neo-classicals emphasize asymmetries of information, utility maximisation by both principal and agent, information costs, strategic behaviour, and incomplete contracts (e.g. ARROW [1985]; MULLIGAN [1997]; REES [1985a and 1985b]; ROSS [1973]; STIGLITZ [1987]; USHER [1992, 288-97]). Moral hazard and adverse selection are common themes. The agent is assumed to have an incentive to shirk; the principal's job is to design a compensation package that will motivate the agent to work in such a way that the principal's utility is maximized. "The main purpose of principal-agent theory is to characterize the optimal forms of such (P-A) contracts under various assumptions... and... to explain the characteristics of (the) contracts which are

actually observed" (REES [1985a, 3]).

This P-A literature often applies the tools of neo-classical economics to fields not traditionally considered as economic. For REES, the P-A problem is one of

> "delegated choice: one individual has the responsibility for taking decisions supposedly in the interests of one or more others, in return for some kind of payment... (W)hen this situation is modelled, its formal structure is applicable to an even wider class of problems, *where no formal delegation relationship is explicitly involved*... A contract is to be defined under which *P* (the principal) makes payment *y* to *A* (the agent)... *(T)he term 'contract' is to be interpreted very broadly....*" (REES [1985a: 3; emphasis added]).

Scholars more influenced by the economic literature on the theory of the firm (e.g. ALCHIAN and DEMSETZ [1972]; JENSEN and MECKLING [1976]; PRATT and ZECKHAUSER [1985b]) share with their colleagues in the risk and information field the usual neo-classical behavioural assumptions and a concern with asymmetric information. Scholars influenced by the economic theory of the firm also tend to see P-A problems everywhere; "businesses, workers, consumers and indeed all participants in society at large regularly struggle to deal with the intractable problems that arise in agency relationships" (PRATT and ZECKHAUSER [1985b, 4]). They also often share the neo-classicals' contractarianism.

However, there are important differences between the two schools. Scholars from the theory of the firm tradition are often less abstractly mathematical than their risk and information theory colleagues, and are more likely to be found studying concrete examples of how different types of organizations cope with specific P-A problems. A common theme is that "organizational forms evolve to deal with (P-A problems), and that on average these forms perform reasonably well" (PRATT and ZECKHAUSER [1985b, 4]; see too ALCHIAN and DEMSETZ [1972]; JENSEN

and MECKLING [1976]).

Those rooted more in the sociological-organizational literature (e.g. MITNICK [1992]; MOE [1984]; PETERSEN [1995]) share with their theory of the firm colleagues an interest in the study of concrete situations, though not always with the same full-blooded neo-classical behavioural assumptions (MOE [1984]; see too SAPPINGTON [1991]). The methodological individualism and contractarianism of the neo-classicals are generally toned down or rejected outright in sociology and organization theory, as well as in philosophy (e.g. BOWIE and FREEMAN [1992a]). In these traditions, the organization generally has an existence of its own, more than the sum of implicit and explicit contracts. Concepts like authority, status and discipline appear, even culture. Sociological-organizational authors see the P-A dyad as only one of many types of relationships within a complex organization.

Philosophers close to the sociological-organizational P-A literature dispute the neo-classical behavioural assumptions. More importantly, they point out that P-A conflicts will still arise even in the absence of selfish behaviour, due to asymmetric information or different interpretations of what action is appropriate (BOWIE and FREEMAN [1992b]; DEES [1992]; DeGEORGE [1992]). Altruism and P-A conflict are not incompatible. P-A analysis "can be coupled with any assumptions about human nature" (PETERSEN [1995, 190]).

For their part, legal scholars and ethicists generally emphasize the duty of the agent to subordinate his interests to those of the principal [BOWIE and FREEMAN [1992b]; CLARK [1985]; MUNRO 1987]). Legal theorists of agency are critical of economists' sometimes extreme individualism and contractarianism. There is thus an important tension between the economics-based views of P-A interactions, which tend to see the problem as "how can the principal get the agent to act in the principal's interest, given that the agent is likely to shirk?", and legal theories,

which assume a fiduciary duty on the part of the agent to be faithful, loyal, honest and diligent. We shall return to this tension in due course.

Finally, Ray REES, in two important articles (REES [1985a; 1985b]) has given us two important extensions of the neo-classical economic view of P-A interactions. The first, already mentioned above, was the idea that the P-A heuristic can be applied "where no formal delegation relationship is explicitly involved" and where "the term 'contract' is to be interpreted very broadly" (REES [1985a, 3]). The second was the idea of using P-A analysis as "the basis for a critique of institutional structure" (REES [1985b, 84]) where such a structure produces incentives which are incompatible with optimal outcomes. REES gives as an example the case of the managing director of a nationalised industry who is paid a fixed salary regardless of the firm's performance.

3. A Limitation of the P-A Literature - and an Extension

As noted above, the P-A literatures of all schools have focussed on commercial-economic-managerial and political-bureaucratic cases. To date, both principal and agent have been assumed to be rational adults[1] who are morally, legally and intellectually capable of defining and defending their own interests[2]. But consenting adults in P-A relationships can decide where their interests lie and take actions to defend them. Whatever the limitations imposed by asymmetric information, monitoring costs and imperfect contracts, adults are assumed to have (and do have) some ability to define and defend their own interests in the market or, if need be, through the judicial system. There is nothing wrong with this focus on rational adults as long as we recognise that the literature has so far covered on only a sub-set of all P-A interactions.

Cases in which the principal is legally, morally and/or intellectually incapable of designating and managing the agent, and where the principal is therefore assigned an agent by law or custom, have

been excluded from the P-A literature to date. Examples of P-A interactions by-passed by the literature include children and their parents or guardians[3], as well as inhabitants of "total institutions" (GOFFMAN [1961, 1 - 124]) - prisons, mental hospitals and boarding schools - and their minders - guards, psychiatrists and housemasters. Such cases cover roughly 40% of the world's population[4]. Clearly a huge proportion of P-A interactions take place outside the realms which have preoccupied the literature so far.

P-A interactions between legal minors and their guardians are cases where the P-A "contract" is implicit, since the legal minor is incapable of negotiating or signing her own contracts. Still, the family is unambiguously a terrain of P-A tension; the parents implicitly contract to act (i.e. be agents) for the child-principal "in a particular domain of decision problems" (ROSS [1973, 134]), and in so doing implicitly promise both the child and society to govern their actions according to the interests of the child-principal. Given the inability of children[5] to define and defend their interests vis a vis their agents, we are entitled to follow up REES' [1985a; 1985b] suggestion that we use the P-A heuristic in this domain as the basis of an institutional critique whose objective is to determine the optimality of this institutional setup.

Such an institutional critique is especially appropriate given that the immaturity and minor position of child-principals deprive them of many of the tools which adult agents use to reduce or eliminate shirking by their agents. Certain versions of P-A analysis suggest, for example, that principals will try to avoid shirking agents by screening and testing potential agents (PRATT and ZECKHAUSER [1985b]), selecting agents who have a natural affinity of interest with the principal (ALCHIAN and DEMSETZ [1972]), or by investing in the loyalty of the agent (MULLIGAN [1997, 323 - 330]; PRATT and ZECKHAUSER [1985b]). Child-principals are very limited in their ability to use such tools. Neo-classical versions of P-A analysis thus suggest we should begin to look for shirking behaviours. Even if there is no parental shirking, however, asymmetric information and/or different interpretations of what is appropriate may still lead to P-

A conflict (DEES [1992]; PETERSEN [1995]). Whatever behavioural assumptions are applied to the parent-agent, then, we have *a priori* grounds to look for P-A conflicts within the family.

4. Shirking and the Fiduciary Relationship within the Family

As noted above, the law of agency requires that the agent should act in good faith *vis a vis* the interests of the principal. The Managing Director is supposed to run the company in the interests of the shareholders, and parents are supposed to act in "the best interests of the child" (UN [1989, art.3]). But because children are incapable or only very imperfectly capable of defining and defending their own interests, problems arise in the defence of the interests of such principals. Who is responsible for defining and defending the interests of such principals? Normally, law and custom assign this duty to the parents, in other words, to the agent.

The problem here is that we may be close to putting the fox in charge of the chickens. In the P-A literature, the principal supervises the agent[6]. However imperfect that supervision may be, the essential point is that the agent is supervised by someone who has some capability to do so. But in the case of children, the roles are reversed; *the agent supervises the principal, and the principal cannot supervise the agent*. Parents are in charge of children.

Why should this be a problem, though? The answer is twofold, and in order to understand it, one must recall that the economic perspectives on P-A interactions warn us that the agent will have different interests or preferences from the principal, as well as different (usually better) information. In other words, the agent has an incentive to shirk, to work less diligently and ask for more payment than he deserves. The first reason why this poses a problem in the child-parent P-A dyad concerns the structuring of payments and services within the child-parent P-A contract. Parents have social, moral and legal responsibilities for ensuring that the children develop into healthy, responsible members of society. At the same time, children presumably provide some joy

("utility" to the economist) to their parents. This joy/utility could be interpreted in neo-classical terms as the "payment" that the principal (the child) pays to her agent (the parent) for child-rearing services rendered. These payments may not be optimal in the absence of constraints on socially inappropriate or excessive payments (e.g. physical and sexual abuse, child labour) by the child to the parent, since the child-principal is incapable of controlling the rate, level and type of payments exacted by the parent-agent. Similarly, the child-principal may be forced to make payments to the parent-agent even if the parent shirks on his responsibilities for providing food, clothing, shelter, education and emotional support to the child; such shirking is known as child neglect.

The second reason why it may be problematic for the parent-agent to supervise the child-principal lies in the social context in which the child-parent P-A contract is embedded. The fact is that this child-parent P-A "contract" is made under conditions which differ radically from the conditions under which spontaneous orders (HAYEK [1976, *passim.*]) can best be left to function on their own. Private contracts will tend to produce efficient outcomes and are therefore best left alone:

a) where information is widely shared

b) where information is available cheaply and efficiently

c) where parties can easily understand the information available

d) where the costs of wrong choices are low and/or easily reversible, and

e) where tastes are relatively diverse (adapted from BARR [1998, 82]).

A departure from any one of these conditions creates a *prima facie* case for investigating whether outside interventions to correct or compensate for the departure might not yield better results than the spontaneous order would on its own.

While these five conditions apply by and large to the types of P-A interactions discussed in the literature to date[7], they clearly do not apply to the intra-family P-A interactions that concern us

here. The asymmetry of information between children and parents is enormous, especially for young children and infants; this violates a) above. The cost for children of acquiring information is also high compared to parents, even where the children (especially older ones) can understand it; this violates condition b) above. Children, particularly the younger ones, may not be able to understand the information even if they get it; this violates c) above. These three violations individually and collectively are equivalent to saying that children are incapable, or only very imperfectly capable, of defining and defending their own interests.

Additionally, and most importantly, the costs of wrong choices in the child-parent P-A relationship can be very high and irreversible, violating condition d) above. Child abuse and neglect cause permanent physical and psychological damage to the child, and even to the child's children. Lack of proper care, including preventive health care, can lead to permanent disfigurement, disability, stunted psycho-social and/or physical growth, or death. Malnutrition, even of an apparently minor kind, can lead to permanent mental and/or physical damage, even death (UNICEF [1998]). These are only a few of the most obvious examples of permanent and irreversible damage which can occur if an irresponsible or poorly equipped parent-agent is left alone to supervise the child-principal.

The question of tastes, condition e) above, is more complex. There is clearly an enormous range of tastes which can legitimately be exercised in raising a child (shall we raise her as a Catholic or a Hindu? ballet practice or football practice? pink dresses or blue?). At the same time, there are clear limits to tastes as well. No society, for example, allows a parent to extract utility from a child in the form of incest. The exercise of such perverse tastes thus constitutes a violation of condition e).

So, we see that the child-parent P-A "contract" has very different characteristics and is embedded in a context very different from those where society could reasonably permit a "free market" in

such P-A relationships to prevail. Violations of the child-principal's rights will occur and she will be unable to defend herself properly. But how common are such violations of child rights likely to be? There has been a tremendous surge in public awareness of the issues of child abuse and neglect in the last two decades or so. It is now accepted that child abuse and neglect and other forms of domestic violence are distressingly common in all societies (e.g. FOLBRE [1996, parts III - VI]; UNICEF [1997]). Edward ZAJAC [1995] has suggested that "bad" behaviours (like shirking) have a Gaussian distribution; the probability of their occurring is higher in larger organizations than in smaller ones. Large organizations thus have to build stronger defences against shirking than do small organizations[8]. Expressed in P-A language (which ZAJAC does not), where there are more agents, there is a higher likelihood of shirking, *ceteris paribus*.

ZAJAC's suggestion can be fruitfully applied to families. Though some parental altruism may be a reasonable assumption in most cases, the state must assume that where there are so many parent-agents, some agents will shirk at least some of the time. Further, the state must assume that a small number of agents will shirk seriously and repeatedly. And even when there is no selfish shirking, where the number of agents is so large, a certain proportion of P-A interactions will result in severe P-A conflict due to asymmetric information and different interpretations of what action is appropriate, especially when the principals have such difficulty in defending themselves. The defences of society must be built with such cases in mind.

5. Implications for Protecting the Rights of the Minor Principal

The possibly dire consequences of abuse or neglect of fiduciary trust by the parent-agent in defending the rights and interests of the principal who is a legal minor thus lead us to contemplate the old question: who guards the guardians? The obvious answer is that, if the family fails, the state must intervene in its role as the body with responsibility to defend and protect the rights of

all people within its jurisdiction[9]. "Third-party enforcement is never ideal, never perfect... But neither self-enforcement by parties nor trust can be completely successful... A coercive third party is essential" (NORTH [1990, 35]).

Obviously, we are on dangerous ground here. There is a seemingly natural presumption that parents love their children and want the best for them, and a reluctance to have outsiders intervene. The totalitarian potential of detailed state intervention inside families is obvious and entirely unappealing. Still, even a great liberal like Milton FRIEDMAN had to admit that

> the acceptance of the family as the (operative) unit (of society) rests in considerable degree on expediency rather than principle. We believe that parents are generally best able to protect their children and to provide for their development.... But we do not believe in the freedom of parents to do what they will with other people... (A) believer in freedom believes in protecting [children's] ultimate rights.... (FRIEDMAN [1962, 33]).

So, where are we to draw the line? FRIEDMAN admits, after a discussion of the British Mental Deficiency Act of 1914, that this

> paternalistic ground for governmental activity is in many ways the most troublesome to a liberal; for it involves the acceptance of a principle - that some shall decide for others - which he finds objectionable in most applications.... (T)here is no formula that can tell us where to stop.... We must put our faith, here as elsewhere, in a consensus reached by imperfect and biased men through free discussion and trial and error (FRIEDMAN [1962, 33-4]).

There is an important element of truth in this, but clearly it is not enough. Clear legal rules must be established giving state authorities the right to intervene to stop suspected abuse and neglect. Those who are placed in positions which may require them to report suspected abuse and neglect of children (i.e. teachers, medical staff, social workers, community group leaders) must be given

appropriate training, including skills in observing, interviewing and counselling. Administrative criteria must be periodically reviewed in the light of recent scientific and social scientific evidence. Parents who claim that their legitimate rights are being interfered with must be clearly given the right to rebut the accusations and be given a fair hearing, including right of appeal. The whole process must be rule-bound and transparent, and subject to independent judicial review.

What then are the domains in which the state may be required to intervene to protect the interests of the child-principal? And does the above analysis mean anything more than that most liberal of principles, the idea that my rights stop just before they start interfering with yours, and that it is the state's job to punish such transgressions, and prevent them if possible (MILL [1859])? Let us answer the latter question via the first.

The most obvious domain for positive state action is the protection of children from abuse and neglect. Abuse and neglect are clear examples of the violation of children's rights to security of the person and to autonomous development. Even in the liberal minimalist tradition, the state is the guarantor of such rights and must act to prevent and punish such transgressions of the child's rights. But - and this is key - the minor position of the child gives the state special responsibilities here. As an adult, I can decide for myself whether to press charges against the pickpocket who stole my wallet. But a child is in no position *vis a vis* a parent to define and defend her rights in a similar way; therefore the state must sometimes act *in loco parentis*. Hence, schools, social service departments and health services have not only the right, but also the perfect obligation (MILL [1863, ch.5]) or duty, to aggressively investigate suspected child abuse and neglect. Where there is a potential conflict of rights, there must be a *prima facie* presumption in favour of the rights of the minor principal (who cannot properly defend her rights) over those of the major agent (who is presumed to be able to defend his).

Other legal restrictions on the ability of parents to decide for their children justified by P-A considerations include those prohibiting early marriage and the sale of children, and those regulating the legal separation and divorce of parents. The potential for gross violations of children's rights if parents were left alone to decide on these questions is too obvious to require comment.

Another domain where state intervention in family choices is justifiable is education. Education, as Len DOYAL and Ian GOUGH have shown, is essential to the meaningful exercise of the basic human right to autonomy, without which other rights are meaningless (DOYAL and GOUGH [1991]; see too TAYLOR-GOOBY [1991, Ch. 7-8]). The *Convention on the Rights of the Child*, the most widely ratified instrument of international law in human history, recognises education as a right of the child (UN [1989, art.28 - 29]). The widespread adoption of laws on compulsory education for minors constitutes a public recognition of a possible principal-agent problem between parents and children. The state cannot allow minor children to decide for themselves whether or not to go to school, since they are incapable of rationally doing so. And while the state may allow parents to decide - up to a point - where and how to educate their children, the state does not allow parents to decide *whether* to educate their children; the state decides that the child-principal's interest in or right to education outweighs the parent-agent's choice not to educate the child. Because of a potential P-A conflict involving a minor who cannot define or defend her rights and interests adequately and a neglectful or irresponsible parent, the state must intervene to require schooling (MILL [1859: ch.5]). The education of children is a case where society simply cannot allow consumer sovereignty to have absolutely free reign, whether "the consumer" is defined as the parent or the child.

The potential for P-A conflicts within the family also sheds important light on the old debate over whether state welfare services should be delivered in cash or in kind. Liberals often argue against

welfare support delivered in kind, such as food stamps, housing vouchers, free medical care, and clothing allowances, saying that food, housing, health care and clothing, and the balance between expenditures on each of them, are areas where consumer sovereignty should be exercised (e.g. FRIEDMAN [1962, 177 - 195]). The means advocated for promoting this consumer sovereignty are either a simple scheme of straight cash benefits or a negative income tax (e.g. FRIEDMAN [1962, 192]; FRIEDMAN and FRIEDMAN [1980, 120 - 126]; see too BARR [1998, 255 - 267; STIGLITZ [1988, 358-60]). Both of these means pose the same risk of a P-A conflict. The parent-agent may spend the cash benefits on beer rather than on food and clothes for the child-principal. Evidence from those American jurisdictions that have experimented with a negative income tax suggest that it has led to great principal-agent problems (BARRY [1990, 110]). Food stamps, housing vouchers, free health care, clothing allowances and, in low income countries, child supplementary feeding, school fee exemptions and the like are simply the state's (admittedly imperfect) way of pushing the agent's spending pattern towards a pattern that is more in the child-principal's interest than might be the case if parents were allowed to exercise *their* consumer sovereignty. "Misplaced notions of liberty prevent moral obligations from being recognised, and legal obligations from being imposed" (MILL, 1859: ch.5]).

Ironically, some of those who favour giving welfare benefits in cash support the opposite argument when they discuss education. For example, the strength of the above P-A argument must be accepted by those who favour education vouchers (e.g. FRIEDMAN [1962, 89 - 92]; FRIEDMAN and FRIEDMAN [1980, 158 - 171]; see too BARR [1998, 347 - 349]; MILL [1859, ch.5; STIGLITZ [1988: 356, 379-80]; WEALE [1978, 93 - 97]). If there were no P-A problem, then the state could finance children's education via cash grants to parents rather than vouchers. But because Dad might take the cash to the pub and not to the school, vouchers are proposed. Vouchers do not maximise consumer sovereignty, as their supporters claim. Vouchers limit consumer choice to within a certain commodity or service (e.g. education) precisely because

there could be a major P-A problem if this benefit were given in cash.

Health care is another domain where the potential for P-A conflicts argues in favour of provision in kind. The arguments against seeing health care as a commodity in the same sense as corn or haircuts are well known and need not be rehearsed here (ARROW [1963]; see also BARR [1998, 277 - 319]; CULYER [1971]; LIGHT [1992]). If and when health care is commoditized, however, that is, where commercial provision of health care predominates, P-A problems arise. The problem is especially acute at low levels of income, where savings and discretionary income are very limited. In the simplest case, a selfish parent may choose to pay for a visit to the pub instead of a visit to the clinic to investigate little Jane's persistent cough, if there is money only for one and not the other. Household budget surveys throughout the third world show that adult males spend much more on alcohol, cigarettes and entertainment (including "female companionship") than they do on health care for their families, even while there is a health care deficit in the household (e.g. ALDERMAN *et al.* [1995]).

Even if there is no such selfishness or shirking, P-A problems in health care are compounded by the well known informational constraints on rational individual action in health care (ARROW [1963]; LIGHT [1992]). A low-income parent who has enough spare cash to pay for only one medical consultation may not know whether to pay for the cure of her own acute stomach ache (which may be benign) or her child's chronic cough (which may be life-threatening). Free provision of health care both reduces the information constraint on rational decision making by making medical advice available for free, and alleviates the intra-family P-A tension by reducing the trade-off between the welfare of the child-principal and the welfare of the parent-agent.

Another way of looking at the in-cash vs. in-kind controversy is via recent debates on cost recovery or user fees for certain social services. In the 1980s and early 1990s, the World Bank, for example, strongly advocated cost recovery in health care, education and water supply as a

way of increasing the resources available to the social sector in developing countries (e.g. HECHT, OVERHOLT and HOLMBERG [1992]). The possibility of severe P-A conflicts where the parent-agent has to pay for goods or services which primarily benefit the child-principal was glossed over in World Bank publications. Even the critics of cost recovery mention the principal-agent problem only in passing (e.g. LIGHT [1992, 467])[10], if at all. By ignoring the P-A problem, the World Bank is implicitly assuming perfect altruism on the part of parents *and* perfect information held by parents about their children's needs. In other words, parents are assumed to know their children's health (or education) needs and allocate expenditure as if those needs were their own. Not even the most generous advocates of parental altruism would make such a claim.

6. Conclusions

Clearly the family is about much more than just principal-agent interactions. Whether we love our parents and children or loath them, we rarely think about them in such clinical terms. What I hope to have demonstrated in this article is simply that principal-agent analysis is a useful heuristic device for analysing interactions between parents and children and for showing why certain types of state intervention in the "private" sphere of family life are justifiable.

Neo-classical principal-agent analysis suggests that agents have an almost universal incentive to shirk in carrying out the principal's business. Other strands of the P-A literature suggest, though, that even where there is no such selfish behaviour by the agent, P-A conflicts may still arise. The child-parent dyad is a neglected example of principal-agent interactions. While adults have various ways of managing their agents, child-principals are morally, intellectually and legally incapable of defining and defending their own interests *vis a vis* their parent-agents. Principal-agent considerations are thus powerful arguments in favour of certain types of state interventions in family life.

The possibility of P-A conflicts between children and parents argues against cost recovery for many social services, especially health care and education. Furthermore, so-called "paternalistic" provision of certain state welfare services in kind finds its justification in the existence of potential conflicts between the interests of the child-principal and the choices of her parent-agent. Such in-kind welfare provision by the state is not, as liberals have suggested, paternalistic in the sense of interfering in the consumer sovereignty of the parents. "The welfare state is not just about the kindliness of meeting need. It is also about the exercise of state power to stop some people doing what they would otherwise do, in the interests of equal rights" (TAYLOR-GOOBY [1991, 213]).

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[1] Or fictitious persons such as corporations, who are the legal equivalent of adults.

[2] To my knowledge, only Douglass NORTH has made this assumption explicit: "in all discussions of principal/agents and the monitoring problem, we assume that the principal has the power of disciplining the agent and therefore of enforcing agreements" (NORTH [1990, 33]).

[3] The family has only rarely been analysed as a principal-agent interaction. Where it has, the analysis has focussed on intra-household labour allocation, where the principal is the head of the (often polygamous) household, and the agents are the wives and older children of the household head (HADDAD, HODDINOTT and ALDERMAN [1994]; CHAWLA [1993]). MULLIGAN [1997] analyses the family and includes a chapter on P-A analysis, but does not apply the P-A analysis to the family. The P-A analysis of the family used in the current paper is very different from the P-A analysis in these three works.

[4] Fully 37% of the world's population was under 18 years of age in 1995 (UNICEF [1997, Table 10]). Eighteen is the legal age of majority as defined in the UN Convention on the Rights of the Child, which all countries but two have ratified. In developing countries overall, 40% of people are children, and in the least developed countries, 50% of the population are children. Even in the industrialised countries, children form 23% of the population. If one adds in the mentally ill, the terminally senile, those with extreme disabilities and prisoners, at least one quarter of the population of all societies, and well over half the population of many societies, are *de jure* and/or *de facto* principals in the care of some agent.

[5] Henceforth, for the sake of simplicity, we will confine ourselves to using minor children as the exemplar of the P-A dynamic where the principal in incapable or only very imperfectly capable of defining and defending her own interests. No offence is intended to the mentally ill, the terminally senile, the extremely disabled, or prisoners.

[6] Some authors in the P-A literature note that, in a certain sense, the agent also supervises the principal's performance of his side of the contract. For example, employees (or their labour union) supervise the employer's respect of pay schedules and working conditions. See ALCHIAN and DEMSETZ [1972]; DEES [1992]; and PETERSEN [1995].

[7] With some obvious exceptions, e.g. government regulations requiring full and truthful provision of information re. terms and conditions for insurance policies.

[8] This suggestion explains, inter alia, the relative bureaucratization of IBM and the European Union compared to your local bridge club.

[9] Both "family" and "state" can be defined very broadly here. The family can be defined as the extended family or the clan in many cultures, and the state can include traditional authorities outside the modern state, as well as quasi- and non-governmental bodies designated or delegated by the state.

[10] To my knowledge, only REDDY and VANDEMOORTELE [1996, 38-41] gave the P-A issue any serious consideration in discussions of user fees for social services.