Section III

Philosophy of Economics and Catholic Social Thought

10. Overlapping Ideas: Catholic Social Thought and Recent Nobel Laureates in Economics

Abstract

Economic doctrine is interested in the efficient use of resources for production and consumption. It often uses mathematical and geometric arguments in order to speak authoritatively. Catholic Social Thought and most religious ethics are more directly concerned with what the economy does to people, particularly to the poor. These traditions use the message of sacred texts or moral reasoning to make authoritative demands. I will demonstrate that, notwithstanding their different methods and interests, there are important areas where these different discourses about the economy acknowledge each other's authority. I will begin by emphasizing the obvious difference between these two discourses about the economy and end by pointing to multiple forms of overlapping concerns.

I. Multiple Authorities in Economics

A. The Authority of Economic Theory

As economics is the study of the efficient use of scarce resources, it is a science which cannot avoid making recommendations. Economics is a science with prescriptive goals.[237] The development of economic theory

[237] Of course, economists do a lot of descriptive work. They provide reports on price levels. They also provide reports on quantities produced in many sectors of the economy, such as the agricultural sector, the service sector, the health sector, and so on. Economists also provide reports that have implicit or explicit recommendations. Thus, a report on the mortgage interest rates charged by different banks leads to the recommendation that taking the lowest interest rate – other things being equal – is the only efficient course of action. For

is the attempt to make such recommendations authoritative. Economic theory has for that purpose developed mathematical and geometric models. In order to build mathematical or geometric models, economists need to specify their model. They need to make a number of assumptions, and these assumptions limit the applicability of conclusions drawn from the model to those parts of the reality that fit the assumptions. Economists interpret the idea of "fit" as "fit reasonably well for the purpose at hand." The application of an economic model to a concrete case thus demands that the economist judge that the reality is sufficiently close to the model so that the model's conclusions apply to the reality under consideration. Such judgments can vary from claims that the assumptions of the model are generally acceptable (apples, bananas, and pears are presented in the markets in units that are close enough to the assumption of the theory that units of production and sale are infinitely divisible), to claims that the assumptions are generally not accepted (distance and time separating producer from ultimate consumer do matter even if the model has no space and time variable). The question then arises: who has the authority to make the decision that the assumptions of the model are close enough to the reality to accept the recommendations of the model in a concrete situation?

To illustrate the difficulties involved, recall that there is an economic correlation called the "Phillips curve" that claims that there is a significant relation between the percentage change in money wages and the level of unemployment (increase the money wages and unemployment can be expected to increase). According to the standard interpretation of the model, if one judges the price elasticity of demand for labor to have a value greater than one, then it follows that an increase in the minimum wage will result not only in an increase in unemployment but also in a decrease of the total wage income of the affected workers. A policy to increase the minimum wage under such circumstances would therefore have two undesirable consequences. However, were one to judge that in the particular case the price elasticity of the demand for labor is zero, then economic reasoning tells us that no one would lose a job as a consequence of the policy and that all workers involved would earn more.[238] The need for a judgment about the applicability of economic models sets a limit to the absolute authority of economic models: Economic models have absolute authority

---

an illustration of the descriptive work done by economists see any publication of the US Census Bureau.

[238] For a recent article questioning the general validity of the Phillips curve and the proposition that minimum wage legislation necessarily increases unemployment, see Prasch & Sheth 1999.

only for the conclusions of the model, not for the applicability of the conclusions to the reality.

I will now show that economic theory demonstrates that there are crucial limitations to its own authority not just in the application of models, but in the construction and interpretation of models. I take as the focus of my argument an influential paper by Francis Bator, wherein he neatly summarizes the theory of welfare economics: "The simple analytics of welfare maximization" (Bator 1957). As the title suggests, Bator makes a number of recommendations concerning how a society could maximize its welfare. More than two thousand years before Bator, Plato had already considered maximization of welfare to be an integral part of justice. Indeed, any interference with the possibility of producing the maximum welfare in society results in there being less resources available within society to share or to distribute. Some people could therefore receive less than they could have received if welfare maximization had not been impeded. Plato considered such interference a form of injustice. Bator's model must therefore be given ethical authority in matters of economics.

Bator's model makes a number of simplifying assumptions – e.g., Bator reduces his economy to two persons, two input factors (land and labor), and two products (apples and nuts). Bator's model also includes a number of less obvious assumptions – explained in a footnote[239] – such as the idea that the two inputs are perfectly divisible, homogeneous, and inelastically supplied. Or, in other words, he assumes that all production functions have a "smooth curvature...[and] neoclassical generalized diminishing returns obtain in all but one dimension – returns to scale are assumed [to be] constant" (Bator 23).[240]

By means of his model, Bator is able to demonstrate that three rules must be obeyed in order to maximize social welfare. One rule relates to

[239] The assumption of smooth curvature implies that all inputs and outputs are infinitely divisible. Thus the model has the option of using land in increments of one acre, half an acre, a tenth of an acre, a square foot, half a square foot, etc. The model also has the option of using labor in increments of one laborer, half a laborer, one month's work, one week's work, one day's work, etc. The model also assumes that apples can be produced in increments of, say, one hundred pounds, ten pounds, one pound, half a pound, one apple – and here the unrealistic dimension of the assumption emerges – half an apple, one fourth of an apple, etc. One could therefore describe physically impossible situations where all of the land is turned over to the production of nuts except for one square inch upon which part of an apple tree is supposed to grow and which is supposed to produce some minute fraction of an apple. The neoclassical assumption of generalized diminishing returns means that for a fixed amount of one production factor, say land, the use of a third laborer will lead to a greater production of apples than the use of two laborers, but that the increase in production due to the third laborer's work is postulated to be less than the previous production increase made possible by the hiring of the second laborer.

[240] For an enumeration of these and other assumptions see Bator 23.

production, another rule relates to consumption, and a third rule relates to the co-ordination of production and consumption. I will summarize Bator's arguments for each of these three rules below and state the appropriate rule at the end of each argument.[241]

Let us start by analyzing the production rule. In Bator's model there are two products: apples and nuts. The only resources available to produce these are land and labor. No third factor, say fertilizer, can be used. If the model calls for the production of a thousand pounds of apples and further assigns 100 acres for apple production, then a good farmer will know exactly how many hours of labor are required to produce the desired quantity of apples. Bator captures the knowledge of the farmer by referring to a production function, that stipulates what inputs are required for given outputs under current technology. Having fixed the input and output levels for the production of apples, all remaining resources of land and labor are dedicated to the production of nuts. If some quantity of land or labor is not used when it could be used productively, then the economy does not produce at its possible maximum.[242] However, even if all land and all labor is used most production decisions would still be inefficient.[243]

[241] Advice to non-economists: the validity of these three rules is what the reader needs to understand or accept. I spend the most time with the argument for the first rule because there is a great similarity in the arguments for the three rules.

[242] If using one more laborer to pick apples would mean that the other laborers are hindered more than the last laborer contributes to production then it may be efficient to leave that laborer unemployed.

[243] The line called "Pareto Efficient Production Line" represents the only points that are efficient. Clearly, most production decisions can lead to inefficient results.

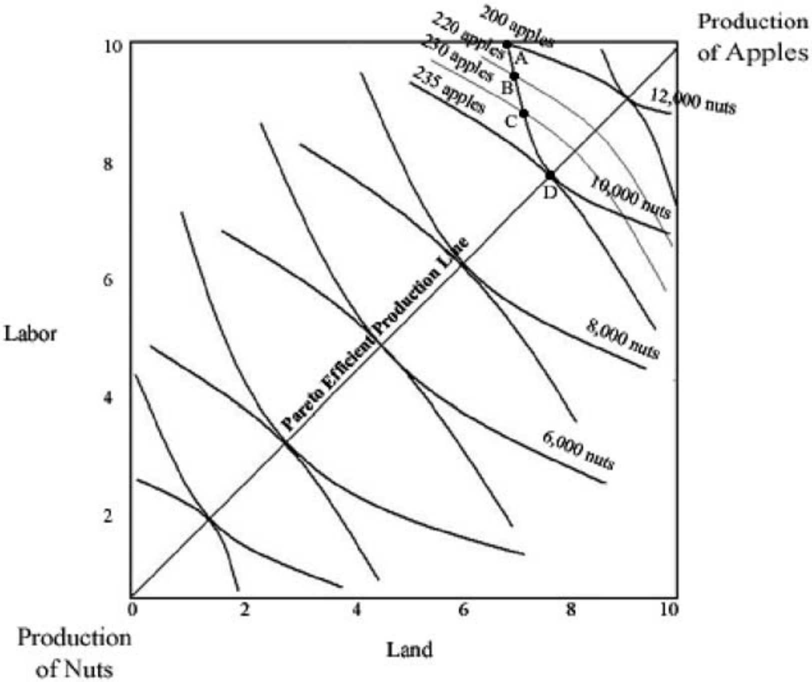

Figure 1.

Let us take the simple example of a model that devotes half of 10 acres land to nuts, the remaining 5 acres to growing apples, and assigns all workers (10) to picking nuts (Point A). Obviously the model would produce zero apples and some quantity (let us say 10,000) of nuts. An economist would suggest that one worker be reassigned from picking nuts to picking apples. Having lost one worker in nut production overall nut production would decline unless additional land (say 1/2 acre) be dedicated to nuts. As a consequence of the economist's advice nut production lost one worker and gained 1/2 acre of land (Point B). This judicious change in input mix (more of one input; less of the other) leaves the nut production at the original level. However, apple production increases drastically from zero to, say, 220 apples. This increase comes about because apple production is assigned a laborer for the first time. Losing 1/2 acre of land for apple production is more than compensated for by the gain of one laborer. The economist again advices that we shift one of the nine nut laborers away from nut production to apple production and recoup the loss in nut production with land – say, that the total amount of rededicated land is brought to .55acres – so that nut production stays the same (Point C). Apple production again increases, with a total of, say, 230 apples being produced. The economist will offer the same advice of decreasing laborers working in nut production, reassigning them to apple production, and taking just enough land away from apple production to maintain current levels of nut production. As long as the nut production stays the same and the shift in input mix leads to an increase in apple production, the previous mix is considered to be inefficient. However, if a small shift in input mix leads to a decrease in apple production while nut production stays the same then we know that the previous mix was more efficient. Efficient production is achieved when changing minimally the mix of inputs leaves the output of both products unchanged (Point D). Technically speaking, efficiency is reached when the rate at which one input must be substituted for another to keep production levels unchanged is the same for both products. In the present model this occurs when the farmer produces 10,000 nuts and 235 apples because for the production of both nuts and apples .57 acres need to be added to compensate for losing one laborer or vice versa. This is called the marginal rate of substitution of production factors.

In our example we started out by giving half of the land (5 acres) and all of the workers to the production of nuts. We could now start our reasoning all over again, reserving some number of acres (e.g., 6, 7, 8, 2, 3, or 4 acres) to the production of nuts and then work out, for each different starting point, what amount of labor is necessary for maintaining the original level of nut production. Each different starting position leads to a different efficient result. The points of efficient input mix for production is called the Pareto efficient production possibility curve. In such an efficient production point the model shows that more production of one output necessarily leads to diminished production of the other output. The miracle of efficiency by which one produces, with the same inputs, more of one output without diminishing the other output is not possible any more at an efficient production point.

If producers are profit motivated and operate in a perfectly competitive environment, it is believed that the producers are automatically motivated to look for such efficient production solutions.

The second rule relates to consumption choices. Given a fixed amount of consumable goods produced by the production process, the question arises as to how the consumer goods should be divided between the two consumers so as to maximize their satisfaction. Again, we can start by giving half of one consumption product – say, nuts – to each of the consumers. All of the apples are then given all to Jane (consumer X); John (consumer Y) receives none.

As economists need to compare things quantitatively – even if only ordinally – they need a unit of consumer satisfaction. In an imaginative move they call the unit of consumer satisfaction a "util." When comparing quantities of utils – say, 200 utils to 400 utils – the rule is that more utils is better. However, while 400 utils is definitely better than 200 utils, one is not allowed to draw the further inference that 400 utils is twice as good as 200 utils. Utils are calculated in ordinal numbers, not in cardinal numbers. Moreover, quantities of utils are not intersubjectively comparable. Thus, if X has 200 utils and Y 400, economists do not allow one to say that Y is better off than X.

Let us now assume that Jane has a satisfaction level of 10,000 utils and John a satisfaction level of 2,000. Suppose John receives 100 nuts from Jane, and Jane needs in return a certain number of apples – say, one – to maintain her present satisfaction level. In other words, Jane is effectively declaring that she is equally satisfied by a basket of 5,000 nuts and 237 apples and a basket of 4,900 nuts and 236 apples. If John now declares that having one apple now, when he had none before, makes him feel better even though he has to give up 100 nuts, then we have moved to a situation where Jane feels equally good and John feels better. Thus trading between Jane and John improved the situation of John and did not worsen the situation of Jane. The after-trade situation may be characterized as more efficient. So long as a trade of one consumer good for another consumer good leaves one person equally well off and improves the well being of the other consumer the pre-trade situation was not optimal. The trade situation becomes optimal when no consumer can be made better without making another one worse off. This is because for both consumers the same amount of nuts is required to make them feel equally well off after having given up one apple. The number of nuts required to substitute for one apple is called the marginal (i.e., at the margin) rate of substitution in consumption.

The original pre-trade situation gave 5,000 nuts to each consumer. We now could give Jane 4,000; 3,000; 2,000; or 6,000; 7,000; 8,000; 9,000 or any amount of nuts in between and start the search for the optimal trade result. Each search would give one point on what is called the utility-possibility frontier. Points on the utility-possibility frontier can be reached only if the consumers benefit in their society from efficient production (i.e., if production has reached the production possibility frontier as defined above).

If consumers are self-interested utility maximizers and no external effects are present (Veblen effect,[244] envy) then it is assumed that private

[244] Thornstein Veblen is famous for his description of the phenomenon of conspicuous consumption. This leads to a phenomenon known to happen in up-scale stores: a product does

property combined with freedom in consumption and in trade will automatically result in society reaching the utility frontier.

The third rule concerns the co-ordination of production and consumption. Production can be efficient at many points. It is possible to achieve efficient results with the production of no apples and all nuts or with all apples and no nuts and for all the maximally feasible combinations in between.

Trading consumption goods for maximum satisfaction too can be efficient at many points depending upon the starting point. If Jane starts off possessing almost all resources the efficient trade outcome would be that Jane ends up with almost all of both nuts and apples. If John starts off possessing almost everything then efficient trade would end up with him having almost all of both apples and nuts. Many different positions in between are likewise possible.

To each efficient production outcome there corresponds an infinite number of efficient trade outcomes. As there are an infinite amount of efficient production outcomes possible the number of possible efficient trade outcomes is thus infinity times infinity.

How does economic theory find a rule that selects an efficient coordination? The solution lies in the following observation. At each efficient production solution the producer has the option of giving up the input factors required for producing one product – say, one apple – and of rededicating those freed up resources to the production of all the nuts that can be produced efficiently. The number of nuts that can be produced by giving up one apple is called the (marginal) rate of transformation of apples in nuts. It is this rate which is crucial for co-ordinating production and consumption. Efficient co-ordination of production and consumption requires that the (marginal) rate of transformation in production be equal to the (marginal) rate of substitution in consumption. Indeed, if this equivalence did not hold, one would encounter a situation in which consumers feel that they are indifferent to either one apple or 90 nuts and in which producers would be able to give up producing one apple and produce instead 95 nuts. In this case production and consumption are not efficiently co-ordinated even though both production and consumer trade might be efficient. Overall satisfaction would be increased in our example by asking consumers to give up one apple and redeploying the freed-up resources instead to pro-

not sell well at a particular price but sells much better when the price is doubled. Veblen explains this phenomenon by pointing out that a conspicuous consumer does not so much enjoy the intrinsic qualities of a good as the knowledge that the good is expensive. The logic behind the phenomenon seems to be that the conspicuous consumer feels the more important the more expensive the good is that he or she is consuming. Goods that sell more when the price is increased are said to be subject to the Veblen effect (Veblen 1934).

duce 95 nuts. Ninety nuts would be sufficient to make consumers feel equally well off. Five nuts would remain to make one or both consumers better off. Efficient co-ordination requires that the (marginal) rate of transformation in production be equal to the (marginal) rate of substitution in consumption. For each efficient production point there is an efficient trade point where that equality is true. The sum of all efficiently co-ordinated production-consumption points gives rise to the grand utility-possibility frontier. No trade or change in production choices could make it possible for one consumer to be better off without making another consumer worse off.

In conclusion, economic theory is able to show that by varying production and consumption decisions and by co-ordinating production with consumption, the economy can improve the satisfaction of some consumers without hurting other consumers. This is considered to be an unambiguous improvement in economic efficiency.

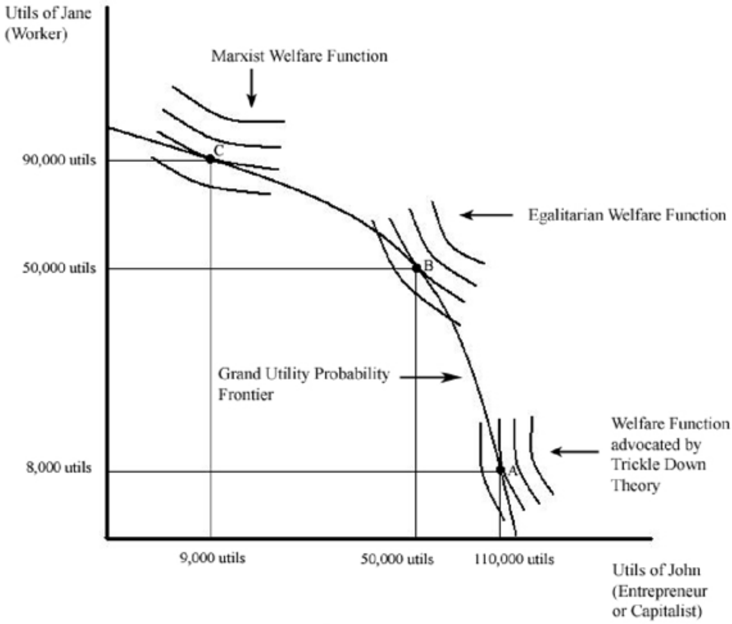

Figure 2.

One more decision has to be made. Bator's economic model tries to give its authoritative approval to a concrete economic reality. Bator clearly demonstrates the limits of economic authority, when confronted with that last necessary decision. The grand-utility possibility frontier is a line showing the joint welfare of two consumers. Examples of points on that line are Jane experiences 50,000 utils (Jane feels a utility level called 50,000 utils) and John experiences 60,000 utils (point B). Other possibilities are Jane at 8,000 and John at 110,000 (point A); Jane at 90,000 and John at 9,000 (point C); there are an infinite number of other possibilities, i.e., all the points on the grand-utility possibility frontier. To decide that the economy must result in situation A would give preference to John – say, an entrepreneur or a capitalist – whereas deciding in favor of B would be favoring a more egalitarian society and deciding in favor of C would be favoring Jane – say, a worker. Such decisions demand that one evaluate the worthiness of the satisfaction of different consumers. Economic theory professes that such an evaluation is not part of its job description. In order to complete its analysis, economic theory assumes that it will be furnished with what it calls a social welfare function by philosophers, politicians, or other people in charge of normatively evaluating human affairs.

In the model discussed, production decisions, consumption decisions, and co-ordination of production and consumption are to be guided by economic rationality. The determination of a welfare function must come from outside the domain that is subject to economic authority.

The implementation of the welfare function can be done by specifying the original endowments. There are only two original endowments or inputs: land and labor. One way to influence the outcome of the grand-utility possibility frontier is to specify the ownership of land (e.g., by land reform, inheritance taxes). If one were to broaden the model one could talk about the ownership of all assets (i.e., property rights in general). The other way to influence the outcome is to see what can be done with labor. Bator's model assumes that labor is fixed and homogeneous. But, clearly it is not. There are disabled persons. Furthermore, the productive value of labor can be greatly increased by training and education.

A different approach to influence the outcome requires the modification of the relative buying power of labor and land (assets). This could be done, for instance, through minimum wage laws, taxes on luxury goods, and differential taxes on labor and assets.

The Bator model gives us enough information to start discussing some disputes of authority about economic matters:

1.) Ironically, the Bator model seems to justify a Marxist line of thinking which argues that property rights are one of the most important factors determining justice in a modern economy. However, Ludwig von Mises had already in 1920 presented an argument for why the socialization of the means of production is an economically bad strategy. Von Mises argued that a central authority could not gather all the information necessary to create an efficient economy requiring the satisfaction of the three rules found in the Bator model. Furthermore, a central authority would not have the motivation (either a profit motive or self-satisfaction) to implement the three rules even if it had the necessary information (Mises 1975). This suggests that other approaches to the problem of property rights, as they relate to issues of justice, need to be considered.

2.) Bator assumes that consumption choices are made efficiently. Actions that thwart efficient consumption choices thus become morally relevant because they hinder the morally desirable goal of economic efficiency. (Examples would include deceptive advertising and deceptive sales practices (including deceptive privatization schemes)). The same can be said of situations that make efficient consumer choices difficult (e.g., lack of easily-available consumer information). Equally morally relevant are irrational consumption choices (e.g., driving when drunk). These are three kinds of events or situations that are to be avoided in order to reach the economically and morally desired efficiency. Some ethical theorists (libertarians) argue that it is morally unacceptable to violate property rights in order to achieve greater efficiency (Nozick 1974).

3.) Production is assumed to be done competitively and motivated by the desire for profit. But what is an economist to advise us to do in situations where the profit motive dictates anti-competitive moves? This raises the possibility of economic and moral justifications of anti-trust legislation and legislation about fair-trade practices. Again, some theorists (economists and ethicists) argue that state intervention in such matters is either not wise or not permissible.

4.) The economy is more complex than Bator's model suggests.[245] There are all kind of transaction costs both in production and in consumption. A proper banking system is one important institutional arrangement to diminish transactions costs. However, pointing towards the need for a banking system introduces the idea of implementing some appropriate governmental regulation of economic institutions.

Let us conclude this section by noting that economic reasoning unavoidably gets entangled in moral questions. These moral questions emerge from within economic reasoning itself and are in no way foreign to it.

[245] See below in the section on Stiglitz.

B. Religious Authority and Economics

1. U.S. Bishops' Pastoral Justice for All

a. Non-Economic Authority in Economic Matters

This document appeals to two forms of authority: the biblical vision and the natural law tradition.

From the biblical tradition the Pastoral derives the claim that "no dimension of human life lies beyond God's care and concern" (# 31). As men and women are made in God's image and as the creation belongs to God, the gift of creation belongs to all men and women (# 34). Being made in God's image makes all human beings free, responsible for co-creation and worthy of sharing in the fruits of the earth's gifts (# 36). Human beings are therefore asked to work productively and to do so in social co-ordination. The vulnerable and the poor are said to deserve special attention.

Turning to natural law, the Pastoral develops the concept of justice, distinguishing between commutative, distributive, and social justice and thereby stressing fairness in transactions, compassion for the poor. Finally, the Pastoral points to the need for institutional arrangements that promote the participation of all in economic life.

b. The Pastoral Letter Makes Use of Its Authority

The Pastoral letter makes use of its special authority in economic matters with sharp rhetorical language. Thus we find the following statements (emphasis mine):

1.) "Harsh poverty *plagues* our country despite its great wealth" (# 16)

2.) "That so many people are poor in a nation as rich as ours is a *social and moral scandal* that we cannot ignore" (# 16).

3.) "Discrimination in job opportunities or income levels on the basis of race, sex or other arbitrary standards can never be justified. It is a *scandal* that such discrimination continues in the United States today" (# 73).

4.) "Among black teenagers unemployment reaches the *scandalous rate* of more than one in three" (# 140).

5.) "It is *patently unjust* to deny workers any role in shaping the outcome of these difficult choices" (# 303).

c. The Pastoral Letter Limits Its Own Authority

There are several indications that the authors of the Pastoral letter accept limitations to their moral authority.

1.) The Pastoral letter explicitly acknowledges the authority of technical economic thinking in the following text: "This document is not a *technical blueprint for economic reform*. Rather, it is an attempt to foster a serious moral analysis leading to a more just economy" (133). Does this mean that a technical economic model has also authority? Which authority has priority? Over what issues?

2.) The Pastoral letter implies a third authority, which is neither that of economic reasoning nor that of religious ethics, even though it might be influenced by both. This third authority is what Hegel called "Geist" (spirit) and is cultural and political in nature. We find the following text: "The first step in such an effort is the development of a *new cultural consensus* that the basic economic conditions of human welfare are essential to human dignity and are due persons by right" (# 83).

3.) When analyzing concrete economic problems with a view toward assessing their moral relevance, the Pastoral letter often mixes two kinds of arguments. The letter clearly advances moral or meritorious goals. However, it also uses public good arguments which are economic arguments based on rational self-interest. And, public goods arguments also entail arguments for limiting the provision of moral goals up to the amount justified by rational self-interest.

2. John Paul II and Centesimus Annus

This document is more favorable to the free market than most other official Catholic documents. Still, John Paul II argues that the economic domain needs to be subordinated to the political domain. I interpret John Paul II as assigning three quite different functions to the state. First, he assigns to the state a necessary structuring function. This structuring function is evident when he writes:

> Economic activity, especially the activity of a market economy, cannot be conducted in an institutional, juridical or political vacuum. On the contrary, it presupposes sure guarantees of individual freedom and private property, as well as a stable currency and efficient public services. (# 48)

Second, John Paul II assigns the state a role in helping the economy reach full employment. This role is described when he argues for the more traditional Catholic – and Keynesian – position that "the state has a duty to sustain business activities by creating conditions which will ensure job opportunities, by stimulating those activities where they are lacking or supporting them in moments of crisis" (# 48).

Third, John Paul II introduces the central idea of Catholic Social Thought – subsidiarity – which allows him to limit the authority of the state. He draws a new application of that idea. Thus he writes:

> in exceptional circumstances the State can also exercise a *substitute function*, when social sectors or business systems are too weak or are just getting under way, and are not equal to the task at hand....Such supplementary interventions, which are justified by urgent reasons touching the common good, must be as brief as possible, so as to avoid removing permanently from society and business systems the functions which are properly theirs, and so as to avoid enlarging excessively the sphere of State intervention to the detriment of both economic and civil freedom. (# 48)

John Paul II chooses to introduce the principle of subsidiarity when discussing the "Welfare State," which is also called the "Social Assistance State" (# 48). In matters of welfare John Paul II argues that the state is not the sole agency responsible; rather, the state should only have a helping function. Individuals and private organizations must be allowed to exercise private charity (# 49). Where individuals and private organizations fail, there the state needs to help. Thus, according to my reading of *Centesimus Annus*, John Paul II differentiates the nature of authority of the state in economic matters into three different kinds. First, there are matters that fall unconditionally under the authority of the state (property rights, stable currency). Second, there are matters where the state is the crucial helper for an economy which performs defectively (business cycle policies). Third, there are matters where the state has a subsidiary function. Here, the state cannot take charge. If the state takes charge, it deprives individuals and private organizations of opportunities. Moreover, the state performs the welfare function inefficiently, and it is unavoidable that it so performs.

II. Overlapping Authority

A. Beyond the Bator Model: More Moral Options in Economic Reasoning[246]

The assumption of infinite divisibility of both outputs and inputs and the assumption that consumption excludes "external effects" means that public goods are not conceptualized in Bator's model (Bator 43, 44 note 44). Samuelson addresses that problem and defined a pure public good as a good that can be consumed by other consumers without the first consumer losing any satisfaction (Samuelson 1954, 387). For private goods that is not possible. If my colleague eats my sandwich, I cannot enjoy it. However, if I buy and install a light in a dark alley, my neighbor can enjoy the safety of the light while I loose none of my own feeling of safety. When goods are public goods, efficient provision of those goods requires in many cases some form of collective action. Samuelson proposes that the state ask citizens how much they would be willing to pay and asks entrepreneurs how much they would charge. If the payment demanded by the entrepreneur is less than the willingness of the citizens to pay then the state should buy the public good and use its taxation power to force the citizens to pay for the public good. If the state does not perform this function then society forgoes an opportunity and thus operates at less than optimal efficiency. In other cases, individuals might come together and take joint private action by, for instance, creating an exclusive club (e.g., for recreation).

At least three kinds of important difficulties have been discussed in the literature with the provision of public goods.[247] If the government takes the initiative, it intends to help citizens to achieve a consumption satisfaction that they might not be able to achieve on their own. The government needs to know what the citizens want and how much they are willing to pay. This information is required for the government to make the calculus as to whether the citizens want the particular public good strongly enough to warrant its provision. This information is then also used to differentially tax the various individuals involved. A taxi driver will have more utility from a bridge than a bicyclist and therefore can be expected to pay more for the cost of building the bridge than the bicyclist. But, given that the

[246] I am here summarizing arguments more fully developed in chapters 5 and 6 in which I present respectively the arguments about merit and public goods.
[247] For a survey of the many difficulties connected with the concept of public good see chapter 6 of this book.

government will use the information about the citizens as a basis for taxation, citizens have a selfish interest in hiding (i.e., lying about) their real interest in public goods. In the provision of public goods, there is an unavoidable information problem (Ibid., 389).

Again, if the public good is provided by private initiative then the exclusionary practice of a club provision of public goods raises the question of discrimination. This is clearly a domain for the moral exercise of state authority.

Lately, a new problem has emerged. Many public goods provided by the state are financed by general revenue. Thus, the decision to provide or not to provide a public good is a political choice (Stretton & Orchard 1994). In the best of circumstances, one may hope that the government makes a list of projects that are economically justified. Given a limited budget, the government must chose which economically-justified public goods should be provided. Will it be a new highway or improved education? Different citizens will benefit differently from the two projects. There will even be a distributive effect. Some public goods benefit the lower classes more; others benefit the well-to-do more. Thus, the decision as to which public goods deserve to be provided has both economic and moral aspects.

Musgrave is credited with having pointed out that there is a third kind of economic good that is neither a private good nor a public good. He calls this third type of good a merit or demerit good (Musgrave 1959, 13–14). Musgrave gives as examples of merit goods: subsidized low cost housing, free hospital care for the poor, and obligatory education. He gives as examples of demerit goods: the prohibition of alcohol and tobacco consumption. He defines a (de)merit good as a good that is so (de)meritorious that the government is justified in interfering with consumer wishes by deciding that the level of consumption is either too low (merit good) or too high (demerit good). Clearly, the concept of a merit good does not respect the consumer sovereignty tradition. Moral arguments will therefore be needed to justify such government interventions. Musgrave finds the cases of economic events requiring moral justification important enough to create a special concept for them.[248]

[248] Musgrave consistently limits the applicability of his new concept. On philosophical grounds I argued for an expansion of the concept (Chapter 5 of this book).

B. Religious Documents Use (Submit to) Economic Reasoning

Some moral documents about the economy mix public good and merit good arguments. A merit good argument points to moral arguments as having authority over the economy. A public good argument points to self-interest and thus to a strictly economic argument as having authority in economic matters. One might therefore wonder whether moral documents that employ public good arguments effectively subordinate their moral arguments to purely economic arguments. Let us survey some examples of such mixed argumentation.

The Pastoral letter *Justice for All* points to "Full employment [as] the foundation of a just economy" (# 136). The document then points to documented losses from unemployment. "It gives rise to family quarrels, greater consumption of alcohol, child abuse, spouse abuse, divorce and higher rates of infant mortality" (# 141). The "strains of job loss may drive individuals to suicide" (# 141). "Jobless people pay little or no taxes, thus lowering the revenues for cities, states and the federal government" (# 142). "[R]ising unemployment requires greater expenditures for unemployment compensation, food stamps, welfare and other assistance" (# 142). "The Federal Bureau of Prisons reports that increases in unemployment have been followed by increases in the prison population" (# 142). The public goods argument is then summarized as follows: "we simply cannot afford to have millions of able-bodied men and women unemployed. We cannot afford the economic costs, the social dislocation and the enormous human tragedies caused by unemployment" (# 143). However, the public goods argument (as developed by Samuelson) would demand that one ask citizens how much they are willing to pay to increase the level of employment – taking all advantages of employment into account – and that one then calculate the costs of public works or public subsidies for increasing employment. However, such an approach implies that one is willing to limit the commitment of funds to those that the public is willing to pay and thus that one is willing to live with the unemployment level resulting from the limitation of funding.

At this point the Pastoral shifts gears. It introduces a merit good argument which does not seem to accept a tolerable level of unemployment. Rather the authors of the Pastoral present a moral argument and make a moral appeal. The moral argument is articulated thus: "In the end, however, what we can least afford is the assault on human dignity that occurs when millions are left without adequate employment" (# 143). The moral appeal is formulated as: "current levels of unemployment are intolerable, and they impose on us a moral obligation to work for policies that will reduce joblessness"(# 143) or "We must make it possible as a nation for *everyone* who is seeking a job to find employment *within a reasonable amount of time*" (# 136) (Emphasis is mine). The argument for such an appeal is based on a moral claim: "human work has a special dignity and is a key to achieving justice in society" (# 136); and again "work has a threefold moral significance" (# 97). The recommendation is not to find the efficient level at which willingness to pay matches the costs of increased employment. The demand is that unemployment be eliminated. As cost considerations are not determinative, such a demand does not aim at economic efficiency.

The Pastoral also points to poverty as a moral scandal (# 16). One method advocated for fighting poverty is to ensure just wages through, for instance, increasing the minimum wage (# 197). For that idea the Pastoral presents a public good argument: "the persistence of poverty harms the larger society because the depressed purchasing power of the poor contributes to the periodic cycles of stagnation in the economy" (# 196). Another method advocated for fighting poverty is the use of education because "lack of adequate education, especially in the inner-city setting, prevents many poor people from escaping poverty" (# 203). For that idea, too, the Pastoral presents a public good argument: "Working to improve education in our society is an investment in the future" (# 204). However, the Pastoral does not seem to be willing to limit assistance to the poor to the limits dictated by public goods arguments. Public goods arguments insist on limiting the cost connected with an increase in the minimum wage to the sum total of benefits that result from the increase and thus benefit the whole economy. These arguments limit investment in education of the poor to what can be defended as investment in the future. At the moment when investment in machinery or in medical schools leads to a greater expected return on investment then investment in the education of the poor would have to be halted. However, the Pastoral seems to have a different attitude toward poverty. The Pastoral does not advocate that poverty be remedied to the extent that it is economically beneficial. Rather, the authors move from a public good argument to a merit good argument when they write that "Dealing with poverty is...a moral imperative of the highest priority" (# 170) and "The themes of human dignity and the preferential option for the poor ... compel us to confront the issue of poverty with a real sense of urgency" (186). One of the causes of poverty is that: "Many poor people are working, but at wages insufficient to lift them out of poverty" (# 174). John Paul II defines sufficient wages as wages that "enable [a workman] to support himself, his wife and his children," i.e., as a family wage (John Paul II 1991, p.18, no 8). The Pastoral and John Paul II have in mind a moral or meritorious goal: establishing just (family) wages and completely eradicating poverty. The public good arguments appear as preliminary steps toward the more ambitious moral and/or meritorious goals of full employment, just wages, and the eradication of poverty.

Is mixing public good and merit good arguments hypocritical? The Pastoral explicitly appeals to an argument (public goods) which has build-in limits and whose limits it does not accept. I believe that there is a more constructive way of viewing the Pastoral's mix of argumentation. The Pastoral is primarily motivated by a moral or meritorious goal. The authors of the Pastoral Letter are aware that moral motivation is a scarce commodity. Therefore, they look for other motivations that can nudge the members of the community in the direction of their goal. Motivation is achieved by appeals to enlightened self-interest as it is embedded in public good arguments. Not implementing the recommendations of economic public good arguments is missing an opportunity for gain. If a public good argument points the community in the direction of a moral goal then the scarce resources of moral motivation will have to shoulder a lighter burden. Such an argumentative strategy also makes it possible for those who are morally motivated to take the first necessary social steps in communion with the larger community. Fostering such solidarity with one's fellows in the pursuit of the common good is itself a worthwhile moral goal.

III. Economists and Catholic Social Thought

A. Buchanan and the Moral Idea of Fairness in Starting Positions

Buchanan is very sensitive to insights derivable from Bator's model: the competitive free market is motivated to push automatically towards the grand utility frontier and thus all interference with the market process should be avoided. On the other hand, Buchanan acknowledges that there is a question of fairness. Buchanan captures the American principles of fairness by referring to the White House Easter hunt (Buchanan 1983, 59–

60). In order to make the hunt fair, small children are given an advantage and older children are handicapped. The purpose is to make sure that all have an equal opportunity. Similarly, Buchanan accepts the idea of fairness as equal opportunity for all in the American economy. He distinguishes four factors in the success of individuals: good choices, luck, effort, and birth (Id., 58). Good choices and effort deserve to be rewarded. Luck cannot be controlled. That leaves birth. Buchanan argues that birth is an important factor in the success of an individual. One can be born with native intelligence or one can be disabled. One can be born into poverty or into great wealth. Buchanan argues that the American conception of fairness demands that one address such inherent forms of unequal opportunity. Interfering with the market process by legislating minimum wages or providing low income housing are, for Buchanan, all interventions that violate the rule of market efficiency. On the basis of economic arguments, help is only allowed as a re-arrangement of initial conditions. Bator's original model presented two initial factors of production: land (which can be generalized as wealth) and labor. Buchanan proposes that inheritances be heavily taxed so as to make the material starting conditions of all citizens more equal. He then proposes to use the revenue from inheritance taxes to finance public education. Free public education equalizes the earning potential of all citizens.

Buchanan himself greatly stresses that his proposal cannot be understood in the light of or be justified by appeals to the concept of public good (Buchanan 1983, 65). Indeed, the public good argument for education is based on the joint or collective consumption of education. Buchanan's argument for making education public is his concern for "potential adjustments in starting positions...making the game 'fair'" (Ibid.). Buchanan's argument for publicly financing education is thus a moral or a merit-based argument. His suggestions aim at handicapping some privileged individuals and improving the chances of others so as to create more equal opportunities for all.

Public education as a commodity whose general provision is justified by a public good argument should be limited to what the people want to pay for and should ideally be financed by user fees (tuition). Indeed, the central idea of a public good is that people take joint action because there is joint consumption. The goal of the joint action is that nobody should be worse off and that some should be better off. Public education justified by a moral or meritorious argument is not limited to what people are voluntarily willing to pay. A moral or meritorious goal is aimed at a result that is deemed (morally) good and some citizens will be charged more than they get back in return.

Buchanan's view on education is similar to the view developed in the Pastoral letter in that both want to use public financing of education as a means to a moral goal. Buchanan wants to achieve a more equal starting position for all citizens and the Pastoral wants to lift the poor out of poverty.

B. Stiglitz: Criticizing Economic Theory in the Name of both Economic and Moral Goals

Joseph E. Stiglitz argues in his "Whither Reform? Ten Years of the Transition" that the Washington consensus, as it is based on conventional neoclassical economics, misunderstands the working of the modern economy. As a consequence, the transition from a command economy to a market economy in Eastern-Europe and the former Soviet Union has been badly mismanaged. Let me briefly summarize again the facts which form the basis for Stiglitz's reasoning.[249] Stiglitz presents a chart comparing the 1989 and 1997 GDPs (Gross Domestic Product) of these countries. Only Poland had a slightly higher GDP in 1997. All other countries had a lower GDP in 1997 than in 1989 (Stiglitz's Figure 3). Countries such as China and India, which regularly violate the recommendations of Western economic theory increased their GDP each year, sometimes with double digit numbers. Also alarming is that Russia not only lost about half its GDP in that period, but the Gini coefficient of inequality[250] in that time period roughly doubled (Stiglitz's Figure 2).

The basic thesis of Stiglitz is that "conventional neoclassical economics are likely to underestimate the importance of informational problems, including those arising from the problems of corporate governance; of social and organizational capital; and of the institutional and legal infrastructure required to make an effective market economy" (Stiglitz, Abstract). Put in another way, Stiglitz argues that it is true that the success of the market economy is connected to the fact that prices are used as signals to coordinate production.[251] However, "Prices do not convey all the relevant in

[249] For the development of Stiglitz's ideas about the misunderstood role of entrepreneurial talent in the countries of the FSU see Chapter 9, Section IV.

[250] The Gini index of inequality is a number between zero and one that indicates the inequality of income in a country. A Gini index approaching zero indicates that the country approaches almost total equality of income). A Gini index approaching one indicates that the country has almost complete inequality of income (one person having almost all income).

[251] The publications of Arrow and Debreu have proven this insight mathematically (Arrow & Debreu 1954).

formation" (Stiglitz 4).[252] Let us concentrate on one of the author's arguments: institutional and legal infrastructure in the economy.

Stiglitz refers approvingly to Schumpeter's idea of creative destruction in a well-functioning economy. Some factories or corporations use resources (material and labor) in such an inefficient way (because they produce inefficiently or because they produce unwanted gadgets) that they must be allowed to go bankrupt. Bankruptcy of an inefficient corporation allows for those resources to be redeployed for more efficient usage, creating a total economy that operates more efficiently. The pain of bankruptcy is a necessary condition for moving the total economy to a higher utility frontier. However, Stiglitz rightly points to the legal and social institutions required for the destructive part of bankruptcy to become creative.

A first condition for bankruptcy to become a positive move toward improvement for the total economy is that there be more efficient alternatives available. If there are no better alternatives available, then the inefficiently-used resources will not be re-employed more efficiently; rather, they will become idle. Large-scale unemployment means that the economy allows inefficiently used resources to not be used at all. Making no use of resources is not an improvement relative to the meager yet still positive productivity of inefficiently-used ones (Stiglitz 6).[253] Where there is large scale unemployment Stiglitz argues (in a manner consonant with Catholic Social Thought) that "Vigorous programs of employment creation and maintenance [even if partially inefficient!], through promotion of entrepreneurship and/or by Keynesian stimuli, must go hand in hand, if not precede, bankruptcy-induced restructuring" (Stiglitz 8).

A second condition for the destructive aspect of bankruptcy to become creative is that the two pillars of creative economics be solidly in place: entrepreneurship and banking. Entrepreneurship existed in former communist countries. However, under communist regimes workers had acquired skills that are not useful for "creating new businesses and compet-

---

[252] Stiglitz refers to the following authors who point to important economic information not conveyed by prices: Marshall, Keynes, Berle and Means, Galbraith, Baumol.

[253] Martin Summers, the East European Desk Officer for the Catholic Fund for Overseas Development in Great Britain presented similar ideas in the November 10–13, 1993 Zagreb Conference on the usefulness of Catholic Social Thought for the transition from a command economy to the free market. He explicitly warned: "Post-Communist countries are, however, as vulnerable as any to the disempowering process of the de-regulated international market." (Summers 1994, 244). He also writes: "the upsurge of New Economic approaches...does hold out the promise of a significant re-localization of economic activity" (Ibid., 245). His suggestions are micro-suggestions which do not form an overall plan for economic reform in Eastern Europe. Summers shows unease with the then-prevailing hope that international competition will do the job and he makes some modest alternative suggestions. Summers argues tentatively for what Stiglitz now argues for forcefully.

ing in the international market place" (Stiglitz 7). Indeed, good entrepreneurs under communism "acquired skills in evading government regulations, in arbitraging away some of the inefficiencies in government regulations for private profit, and in operating at the interstices between the legal and the illegal world" (Ibid.). In communist countries there were institutions that were called banks. But that "banking system had no experience in screening and monitoring loans" and few banks "actually got into the business of providing funds to new, small enterprises" (Stiglitz 7). Thus the lack of the proper experience in the banking institutions resulted in entrepreneurs with good ideas not receiving the capital necessary for realizing possible innovations and thus employing more productively the resources idled by bankruptcies.

A third condition for the potential creative dimension of bankruptcy is a legal framework that includes bankruptcy laws and judges capable of applying those laws. In bankruptcy there is a conflict between creditor and debtor. Stiglitz refers approvingly to Supreme Court Justice William O. Douglas and Henry Clay when they claim that the interest of the State in bankruptcy is "in all the faculties of its members, moral and physical" (Stiglitz 7). The speed and manner in which the "assets can be re-engaged in productive use" is a crucial consideration. (Ibid., 7). The advice that in ex-communist countries one should simply enforce bankruptcy laws is therefore empty advice. Bankruptcy laws barely existed and were rarely applied under communism. Neither the law nor the experience of judges existed to promote the creative redeployment of the resources of bankrupt enterprises.

Stiglitz argues that reformers cannot hope that the imposition of pure free market competition in the absence of appropriate legal and institutional arrangements will be effective. He concludes that one first will have to create "the implicit social contract, necessary to a market economy" (Stiglitz 8). This is a theme that is also stressed in Catholic Social Thought.

Conclusion

Adam Smith sometimes argues that the economy is a natural system (651). He seems to imply that economics and nature have the same ontology: they are both governed by immutable laws. Violating these immutable laws of economics leads to unproductive usage of resources, as Adam Smith argues was the case with societies where governments intervened (improperly) in the name of mercantilism or physiocratic economic theories (650–51).

Hegel, on the other hand, looks upon the economy as an ethical institution (Hegel 1967 a, ## 182–256; Ver Eecke 1983; Chapter 3 in this book). The economy has an important role to play in the promotion of freedom. A successful economy liberates human beings from the tyranny of nature by preventing starvation and by elevating natural needs to cultural events (meals as social gatherings, clothing as cultural expressions). A successful economy also provides a domain where human beings can realize important aspects of their freedom: it allows individuals to achieve dignity in and through work. Finally, a successful economy encourages individuals to transcend their individuality and realize the social vocation of human beings. The economy gives rise to many morally desirable forms of social interaction, to the formation of social groups, and to the exercise of some types of social caring. Hegel agrees that economic activity is carried out within a double form of determinism: the determinism of nature and the determinism of social interaction. Hegel would thus reject a purely voluntarist moral view of the economy but would also reject a purely deterministic approach devoid of moral responsibility.

Like Hegel, Adam Smith, in his concrete analyses, also assigns moral responsibility to economic agents and argues in favor of responsible actions but against irresponsible ones.[254]

Given that the economic domain is a domain of natural laws and a domain of moral responsibility,[255] it is not surprising to have discovered that, *de facto*, both the economic and the moral discourse about the economy are discovering and respecting the dual ontological nature of the economy. What some might criticize as an illegitimate confusion in the two discourses on the economy should rather be applauded as the discovery of and manifestation of a proper respect for the ontological complexity of the economic domain.

[254] For a general argument in favor of responsible intervention in the economy see Adam Smith's considerations about public works and public institutions (651 and Book V, Ch I, Part III). For a general argument against irresponsible intervention in the economy see Adam Smith's argument against the use of government regulations for the creation of private benefit (250).

[255] Goetz Briefs concludes his masterful essay on the history of the influence of ethics on economics as follows: "A degree of freedom exists, and there are functions of the state that are vital. But we realize now as never before the existence both of a realm of necessity ruled by economic laws and of a variable zone of freedom. Because of this freedom, ethics again has a place in economic life... [and] a place in economics proper"(Briefs 1983, 298).