Section III

Tightening the Argument
A Philosophical Dialogue with Economists

5. The Concept of "Merit Good" and the History of Economic Thought

Abstract

The purpose of this chapter is to defend the concept of "merit good" and to expand its application. This is achieved by using a Kantian argument applied to the writings of foundational economists such as Adam Smith and Henry Simons as well as Walter Eucken in the German literature. As a result, the concept of "merit good" is used to classify and to argue for a number of governmental tasks such as the institutional arrangements needed to make a free market economy work efficiently and in a humane way. Methodologically, this paper connects economic theory, the history of economic thought, and institutional economics, thereby demonstrating that economics is unavoidably intertwined with politics.

The necessity of politically imposed institutional arrangements for the economy to function well and humanely demonstrates the validity of Hegel's claim that the economic domain is an ethical arrangement.

I. The Problem

Fifty eight years ago, Richard A. Musgrave introduced the concept of "merit wants" (1956, 333–4).[90] A decade and a half ago, in a talk for an international conference on the problem of "merit goods," John Head complained that:

> it might perhaps have been expected that the merit wants concept would, by 1987, be showing all the usual signs of maturity in the evolution of an economic concept. Simple questions of definition or interpretation should on this reckoning long since have been resolved, and a broad consensus would

[90] One can find most of the references to the concept of merit good in one anthology: Ver Eecke 2007.

> typically have been reached on fundamental analytical issues relating to normative status and policy relevance. The treatment of the concept in the standard textbooks would by now be routine and highly uniform. In the case of its more celebrated twin, the social want or public good, this familiar process has indeed occurred and has long since appeared substantially complete.
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> As compared with social wants, however, the merit wants concept raises methodologically much more difficult and controversial issues symbolizing as it does, for the public finance literature, many of the doubts and reservations which have been expressed over generations by economists of varying political persuasions regarding the ultimate normative authority of the consumer sovereignty principle. On these issues the views of economists have traditionally seemed poles apart. (1990, 211)

The main purpose of this chapter is to restart the discussion of the concept of "merit good" by demonstrating not only that Musgrave's original intuition was correct, but by also demonstrating that the concept is much more broadly applicable than Musgrave himself envisioned. The acceptance of my broader interpretation of the concept of "merit good" involves a paradigm shift that Musgrave did not fully realize. It requires a shift from an exclusive individualistic view of economics to a socio-economic viewpoint, in which political and institutional arrangements are understood to have a crucial impact on economic performance. If my thesis is accepted, it will be evident that it is unfortunate that the introductory textbooks in economics largely omit the concept of "merit good." It will also be evident that it is deplorable that the discussion of the merit good problem has become sparse in the literature, more sparse in the English economic literature than in the German one. Much still needs to be discussed about the methods of economically analyzing problems of merit goods. But let us start from the beginning.

While writing an article in 1956 about the theory of governmental budgets, Musgrave discovered an argument for ethical concepts in economic thinking by introducing the concepts of "merit want" or "merit good" – i.e., areas in the economy where the government is justified in interfering with the preferences of individuals (1956, 333–4).[91] In that arti-

[91] In a recent autobiographical essay, Musgrave writes that his early training in German public finance and in German theory of the state made him sensitive to a domain in economics that could not be handled by the two concepts based on individualistic assumptions: private and public goods. Musgrave there conceptually acknowledges that economics should be socio-economics, and must include reflections on political and institutional arrangements. Consider this quotation: "Admittedly difficult to define and dangerous to entertain, communal concerns have been part of the scene from Plato on, and my concept of merit goods (applicable to private and social goods alike) was to provide a limited opening

cle, Musgrave starts by arguing that the government has three roles to play: a service role, a distribution role, and a stabilization role.

In its service role, the government has to undertake the production of public goods in an optimal way, and it has to find a means of financing that is equally optimal. The financing method takes the form of a tax system. The difficulties which have to be surmounted to accomplish this double task are well known.[92]

In its distribution role, the government has to ensure that the incomes of citizens are allocated in an optimal way. Taxation and monetary transfers are a technically efficient manner of doing this. The main question for the distribution role concerns, however, not the method, but the amount of redistributing that is to be done. Musgrave calls this a problem of social choice. Together with many contemporary economists, he considers this a non-economic problem, i.e., a problem that cannot properly be addressed by economic methods of analysis. The stabilization role consists in the government creating the correct aggregate demand for the creation of full employment without inflation. This role is also known as the government's duty to avoid the negative consequences of the business cycle, particularly those of economic recession and depression.

As a pedagogical device, Musgrave imagines that these three tasks are performed by three separate departments of the government. He also imagines that the three tasks are performed simultaneously. He further supposes that the funds credited and debited to each of these three departments are sent to a computing department, which ensures that each person receives a credit (in the form of a check, for instance), or a debit (an obligation to pay a certain amount of taxes).

But at the end of his article, Musgrave admits that the government performs certain economic activities that cannot be classified neatly in terms

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for their role" (Musgrave 1959 and 1987). "Dutiful performance of civil service remains a constructive concept, as does that of responsible public leadership. Though they now tend to be ridiculed, both these alternative modes are essential to make democracy work. Nor are issues of entitlement and distributive justice reducible to principles of exchange, issues which have to be resolved before that mode can be given its role. The broad-based roots of the German tradition, its linkage to the theory of state and to fiscal sociology (Musgrave 1980) helped to provide awareness of these issues" (Musgrave 1993, 66–7). Still, Musgrave often tried to limit the applicability of the concept of "merit goods" in his economic writings (Musgrave 1987).

[92] Economically optimal pricing for public goods requires that the same good have a different price for different consumers who value the same item differently. Thus, toll booths charge trucks and regular cars differently. Theoretically, the differentiation should not stop at groups. If the individuals within these groups have a different evaluation of the item, then these individuals should be charged a different price. The problem is that it is difficult to know the true evaluation of items by individuals. For a more detailed analysis of the problem, see chapter 6 in this book.

of these three functions. He names two such activities: free medical treatment for the poor and subsidies for low-priced housing (1956, 341). These two examples belong, on the one hand, to the service role because they produce a public good. But this service represents, at the same time, a form of redistribution, because not everyone is entitled to free medical treatment, and not everybody can receive grants for housing. Only a certain class of people is entitled to them. The two cited examples seem, therefore, to be economic activities that belong simultaneously to two government departments: the service and the distribution departments.

Musgrave tries to solve this problem by entertaining the idea that these two examples are cases of pure redistribution. Considered as forms of redistribution, the supplying of free medical treatment and grants for low-cost housing become comparable to monetary transfers, combined with an additional limitation imposed on the free choice of the recipients as to what can be done with this money. This kind of redistribution thus does not respect the sovereignty of the consumer's wishes (in this case the wishes of the poor, the ones receiving subsidies); on the contrary, it imposes limitations on their choices. Musgrave's solution, however, creates a new problem: thus classified, these economic activities seem to disregard the normative economic maxim of consumer sovereignty. He tries to soften this new problem by asking whether or not such a limitation upon consumers should, as a matter of course, be condemned. Musgrave does not believe it should because consumers sometimes make irrational choices. They purchase a second car or a second refrigerator before ensuring that they have adequately prepared for the education of their children. Goods for which the government justifiably restricts the choice of consumers deserve a special name. Musgrave calls them “merit wants (goods)” (Ibid.).

In his later publications Musgrave often comes back to the problem of merit goods. Further examples of merit goods are free education and free school lunches (Musgrave 1959, 13; 1987, 453). The examples of compulsory inoculation and all subsidies in kind could be added. In like manner, we could take as examples of demerit goods sumptuary or “penalty” taxes on liquor (1959, 13) and tobacco.

Beginning in 1959 with the publication of *The Theory of Public Finance*, Musgrave takes an important step by providing a definition of the concept “merit goods” that is independent of his own theory of public finance. A merit good is defined as a good which is so important that when the competent authorities are dissatisfied with the level of consumption in the free market, they can intervene, even against the wishes of consumers (Ibid.).

Musgrave does not feel very comfortable with this new concept. He tries to find different kinds of justifications for the concept of merit good, but he admits that the term remains problematic.[93]

Charles McLure, on the other hand, has no such ambiguous attitude towards the concept of merit good. He states plainly that the concept has *no* place in a normative theory of public finance (1968, 474, 482) and that our Western economic theory knows only one norm: the wishes or preferences of individual consumers. One of the tasks of economic theory, for McLure, is to point out what has to be done to satisfy these wishes as much as possible. This is normative thinking. When economists create normative theories about government finance, they have to remain faithful to this goal, i.e., the goal that government should spend money in order to satisfy the wishes of individual consumers as efficiently as possible. However, when economists introduce the concept of merit good, he says, they try to find out how they can get around the wishes of consumers. They try to find ways of violating the fundamental axiom of free-market economics. Such thinking – i.e., thinking about merit goods – has, therefore, no place in normative economic thinking, according to McLure. He further states that the government often denies the legitimacy of consumer wishes. Economists are allowed to describe this, but they are not allowed to include it in their normative thinking.[94]

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[93] I do not address here the difficulties that Musgrave encounters in trying to differentiate merit goods from public and private goods. Sometimes, he seems to think that merit goods are only applicable to public goods. At other times, he seems to think that merit goods are private goods only. His final position is that merit goods can be both private and public goods (1993, 66–7). I do not address here the problem of the multiple definitions that Musgrave seems to have entertained, which is discussed in Allan G. Pulsipher (1971/72, 278–9). My position is that Musgrave has always rejected a pure authoritarian provision of merit goods, and that he always thought that merit goods were more than a correction of consumer wishes. I understand Musgrave to say that "correction of consumer wishes" covers but a subclass of the merit goods, the total class being better defined as "intervention in consumer wishes." For a documentation of these two problems in Musgrave's texts, see Andel 1984, 631–7). Head claims that Musgrave defines merit goods as "the need to correct individual preferences" (1966, 216). This claim is disputed by, among others, McLure: "Thus by asserting imperfect knowledge to be the heart of merit wants, *Head* seriously misinterprets *Musgrave*" (1968, 477).

[94] In an international conference on the problem of merit goods McLure took a more flexible position (1990, 185). In that same conference, a whole section was devoted to "Irreducibly Social Goods." This paper by Charles Taylor and the comments by Robert E.Goodin, John Broome, Frank Jackson and Peter Gärdenfors are published as part of a book on the conference (Brennan and Walsh, 1990, 45–96). Some of the authors defend irreducibly social goods (merit goods), others reject it, still others believe that it is more important to see the multiple ways in which a good can be social. Clearly, this conference did not produce agreement on the question of the legitimacy of the concept of merit good.

The contrast between Musgrave's and McLure's ideas provides an excellent opportunity to situate ethical thinking in the context of economic thought and to demonstrate anew that economics is in fact socio-economics, requiring explicit reflections about political and institutional arrangements.. Musgrave discovers governmental activities which ignore the wishes of consumers in connection with some goods. McLure argues that the concept of merit good has no place in normative economic thinking. Musgrave admits that he does not have sufficient justification for his new concept but refuses to argue that all intervention by the government which fails to satisfy individual wishes is illicit.

If we agree with McLure, we admit that ethics involves a kind of thinking which is not immediately relevant to economic thinking.[95] If we follow Musgrave, we implicitly accept the thesis that ethics can play a role in economic thinking, although we may momentarily lack sufficient arguments.

Clearly, we are here confronted with a major difficulty. As we are dealing with a normative problem, it would be appropriate to consult philosophical thought (Ver Eecke 1984, 198–202). But first, I wish to sketch the broader context of the problem.

Economic theory speaks about private goods (sugar, bread, oranges) and public goods (national defense, pure air, bridges, roads) (for a good synopsis of the problem of public goods, see Head 1974, chapter 3). Musgrave adds a third concept: merit goods. Economic thinking, per Musgrave's view, thus embraces three kinds of goods. Western economic thinking gives priority to the concept of private good, because this concept is directly connected to the wishes of consumers. The free market is the institution through which private goods are produced and (hopefully) distributed in an optimal way. The two other kinds of goods (public goods and merit goods) are exceptions to the idea of private goods. Therefore, we can call them non-private goods. Since these non-private goods are usually supplied by means of the political system, we can give them another name: political economic goods.[96]

It is important to clearly understand the difference between the two kinds of goods provided by the political system. Public goods are political

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[95] Based on the work of Hausman and McPherson one could make an ad hominem argument against McLure's position. Hausman and McPherson argue that giving absolute authority to individual preferences in order to legitimate economic outcomes is an ethical position itself. Furthermore, it is not defensible neither theoretically, nor politically nor for the forum of common sense. Indeed, a position like McLure's implies that one cannot differentiate between "expensive, anti-social [preferences], or [preferences that are] the result of false beliefs, manipulation, or problematic psychological processes" (Hausman and McPherson 1966, 83). They must all be considered equally valid.

[96] This name was suggested by H. Briefs.

economic goods provided by the government with the intention of respecting the wishes of consumers. The consumers need help because public goods have technical (factual) characteristics that make it difficult for individuals to acquire them in an optimal way. Merit goods, on the other hand, are political economic goods which the government provides by a method, or at a level, which *dis*regards the wishes of consumers.[97]

The above argument allows us to assert that economic theory needs three, and only three, concepts to be complete. Indeed, there is the normative concept of private goods, and in my view, two reasons, and two only, why a good might be non-private: a factual constraint and a value judgment.[98] The factual exception relates to the fact that some goods can be consumed by different consumers simultaneously. These goods are conceptualized as public goods (e.g., a light increasing safety in an alley). The other exception is that some goods are judged to have special moral value: they are judged to be very beneficial or they are judged to be obnoxious. These judgments give rise to the concept of merit good (e.g., education, which is made obligatory) or its opposite demerit goods (e.g., liquor on whose consumption sin taxes are imposed).

Let us further clarify the difference between goods that are non-private because of reasons of fact and those that are non-private because of reasons of value. Economic theory argues, with respect to public goods, both that factual characteristics are the reason why individuals need help and that this help can be given while respecting the wishes of consumers. There are two factual reasons a good might not be a private good: nonrivalness in consumption and impossibility of exclusion.[99] The factual properties of these goods are, therefore, the reason they cannot be considered private goods and, as a consequence, it is not optimal to provide them through the free market.

A completely different exception to private goods occurs when a value judgment is passed that stipulates that the free market does not ensure a desirable level of consumption. This is the case of Musgrave's concept of (de)merit goods. Because value judgments about merit goods are not made

[97] Economists are aware that some preferences are problematic. Thus, John Head points to lack of reliable knowledge (lack of information or presence of persuasive and misleading information) or the presence of irrationality in the consumer as leading causes for problematic preference choices (Head 1974, 217–220).

[98] The above argument implies that economic theory needs at least three sub-concepts for the main concept of economic good. For a study demonstrating the practical importance of using and distinguishing these three concepts see: Godwin (1991, 415–29). An alternative way of introducing value judgments (commitments) in economic theory is Sen's proposal for a hierarchy of preference orderings (Sen 1977, 326–44).

[99] For a further discussion of these characteristics of public goods see chapter 6 in this book.

by individual consumers but by representatives of society (government officials), McLure claims that they should not be part of normative economic thinking, which is itself based on respect of the sovereignty of individual consumers.

The problem, therefore, is: should the concept of merit good belong to normative economic theory? If it should, what are the arguments in favor of its inclusion?

II. Justification of the Term "Merit Good"

McLure accepts the proposition that only one method exists for justifying something economically, namely, compliance with the wishes of individual consumers. When we look at the history of philosophy, we see that one of the major philosophers, Immanuel Kant, built his philosophy on a totally different method of thinking; namely, the transcendental method, which involves the search for conditions of possibility.

Kant's method of thinking consists of focusing on two important facts, and then looking for the conditions of the possibility of these facts. The two facts he was concerned with are the existence of scientific laws and the existence of a feeling of moral obligation (Kant 1956, 166). He deals with the first in the *Critique of Pure Reason* and the second in the *Critique of Practical Reason*. In the *Critique of Pure Reason*, Kant argues against the British empiricists, who assert that knowledge of the world is based solely on sensory perception. Kant asserts that when we look at a table from three different points of view and thus produce three sensory observations, but we claim that there is only one table. Kant asks what the conditions of possibility are for asserting that we only see one table even when we have three sensory impressions. He answers that it is because we live in a world of objects and not in a world of sensory impressions. For Kant, an object is the combination of observed impressions together with the categories of the mind. For example, the table is an object, because we consider it to consist of its observed front together with its postulated back. Or again, due to the category of causality, any material object is the observed phenomenon, together with the postulated continued existence of this observed phenomenon over time.

Kant's argumentation allows us to affirm that if one accepts the idea that there is only one table, then one *must* accept the idea that even though we possess three sense impressions, the real, true perception is the result of the combination of these sense impressions with the categories of the mind. Hence, one must abandon empiricism as a theoretical explanation.

Kant gives us here a new type of method of justification: to look for possibility conditions by means of logical reasoning (Ibid.). This is the same reasoning used in daily life. When my children are thirsty I tell them that they can find drinks in the refrigerator. Whether they feel like it or not, the possibility condition for ending their thirst is for them to get the drinks out of the refrigerator themselves.

In a similar way, one can assert that there are at least two ways to prove that something possesses economic justification. The first way is the familiar way of arguing: that which fulfills, in the best manner, the wishes of the consumers, as they see it, is economically justified. The second way follows the Kantian method of thinking: if citizens and consumers want something, they also have to accept its possibility conditions. They have to accept them whether they want to or not. This second kind of reasoning rests on the insight that there are logical relations in reality. These logical relations have validity, even if consumers do not like them.

We shall call merit goods those goods which are the conditions of possibility of something that is desired by the consumers, even and especially if these merit goods or services themselves are not preferred by consumers.[100] This method of arguing has the advantage that we can set limits to merit goods. The government cannot thwart the wishes of the consumers whenever it feels like it: the government needs arguments. And these arguments set limits to government actions. The government might be annoyed with corporations and might want to punish them. The government cannot punish them because it is annoyed with them. It can punish them if the courts establish that they violated, for instance, anti-trust laws, which I interpret as laws promoting efficient production, which in turn I consider a merit good.

If my philosophical reasoning is correct, it means that economic thinking necessarily has to propose that the government should perform economic activities which interfere with the wishes of some consumers. Let me restate my thoughts in a different way. If my philosophical reasoning is correct, we can assume that economic thinking will propose economic activities to the government which will respect neither the Pareto principle nor the consumer sovereignty principle (examples are banking regulations and anti-trust laws). This means that economists will recommend to the

[100] Such a defense of merit goods leads to the distinction between a potential and an actual merit good. A potential merit good is a good which is a possibility condition for something that consumers want, but which is under current circumstances also desired by the consumers. A potential merit good becomes an actual merit good if it is not wanted itself. This distinction is similar to the one used by Folkers when he distinguishes between merit need and merit good (1974, 23). McLure's definition of merit goods, on the other hand, is restricted to actual interference with consumer preferences (1968, 479).

government some economic activities which might cause disadvantage to some citizens, and might favor others. Economics must therefore necessarily become political economy or socio-economics, where the first label stresses more the political dimension and the second the social dimension involved in providing (de)merit goods (Smith, 1937, 247–50, 651-2, 767–8; Schumpeter, 1954).

Someone might argue here that the provision of public goods sometimes has the same consequence of interfering with consumer wishes, as in the case of the expropriation of land for the creation of highways. But, this comparison between public and merit goods is unwarranted. In the case of public goods, economic theory of optimal allocation requires that those who experience negative utility from its provision must be compensated. Where compensation is not given, because it is impractical or because the consumer is assumed to exaggerate the amount of disutility (strategic behavior), the theory still requires us to regret the inconvenience of the disutilities, because the provision of public goods intends to improve the situation of everybody. Merit goods are another matter. The theory of (de)merit goods does not include the idea that disutilities have to be compensated. Thus, policies aimed at lowering the rate of smoking need not include compensation for the inconvenience imposed on smokers. Similarly, antitrust legislation does not include compensation for the restrictions imposed on monopolists. Disutilities for some are intended in the very concept of merit good (Musgrave & Musgrave, 1973, 80–81). That an economic concept includes the intention of imposing disutilities on some gives us an opportunity to situate, systematically, ethical problems within an economic framework.

In the second part of this chapter, I wish to articulate what the different kinds of merit goods are. It is interesting to discover that these different kinds of merit goods are already present in the history of economic theory. We will discover these different types of merit goods defended by Adam Smith, the neo-liberals, Keynes, and the contemporary theories of the welfare state.

III. Justification of the Different Kinds of Merit Goods

The sole method of justification that we will use is implied in the question: what are the conditions of possibility of a given thing that the citizens, as economic actors, wish?

Western citizens as economic actors wish first for a free market.[101] A free market cannot exist as a factual arrangement if certain conditions are not fulfilled. Adam Smith thought about this intensively in Part V of his *Wealth of Nations*. As conditions for the possibility of the free market Adam Smith names the following: (i) national defense; (ii) a legal system which protects property, enforces contracts, and is executed by judges and politicians; and (iii) bridges, roads, etc., to enhance commerce (653–716, especially 659, 670, 681–2, 690).

The two first tasks are sometimes mentioned as tasks for the minimal state.[102] These tasks cannot be defended by the public goods argument alone, because the provision of these goods does not respect, and does not even intend to respect, the wishes of all consumers. Smith seems to know this very well when he makes the following statement concerning property rights:

> Civil government, so far as it is instituted for the security of property, is in reality instituted for the defense of the rich against the poor, or of those who have some property against those who have none at all. (674)

Furthermore, Smith invokes value judgments for the justification of these governmental activities, a move which would be superfluous or out of place if one used the argument of public goods. Consider Smith's statement:

> Even though the martial spirit of the people were of no use towards the defence of the society, yet to prevent that sort of mental mutilation, deformity, and wretchedness, which cowardice necessarily involves in it, from spreading themselves through the great body of the people, would still deserve the most serious attention of government. (739)

Smith also makes an appeal to a second value judgment when he writes:

[101] One could argue that the free market is not a good per se, but that it is an institutional or legal arrangement. Still, I want to maintain that institutional arrangements are produced. They involve the use of some resources. They result in something that is desired. In as much as institutional arrangements result in something desirable, they are a good or a service. In as much as they require resources they must be called economic goods. Given the necessity of institutional arrangements, which themselves are economic goods, economics is thus necessarily socio-economics. This was clearly understood by Schumpeter (1954). This is also an accepted premise in a recent technical publication (World Bank, 1997) and in a moral analysis of the different economic systems (John Paul II, 1991, ## 24, 29, 34, 35, 36, 40, 42, 48).

[102] The German term is *Rechtsstaat*.

> That degree of liberty which approaches to licentiousness can be tolerated only in countries where the sovereign is secured by a well-regulated standing army (668).

With reference to merit goods, as I have been using the term, Smith not only realizes that the wishes of some consumers are harmed by the minimal state, and that an appeal can be made to value judgments; he also proposes that these goods be financed differently than public goods. Ideally, public goods should be financed through taxation of the individuals who benefit from the use of these goods. Furthermore, the amount of the taxation should be directly linked to the usefulness enjoyed by each consumer. When a consumer derives more use from a bridge because he drives a truck, he should pay more taxes than another consumer who derives much less use from this bridge because he only uses it to ride a bike to his job. For the goods of the minimal state, however, Smith recommends that another method of financing be used. He proposes a financing method which breaks the connection between the amount of taxation and the subjective utility experienced from the provision of the good. Smith proposes that the goods from the minimal state be financed by general revenue to which each contributes according to his ability to pay, independently of the utility he derives from its provision. Appropriately, this method of financing is called the "ability-to-pay-method" (767).

For me, the violation of the wishes of some consumers, the use of value judgments, and the recommendation of a different financing method are three reasons why I do not want to subsume the tasks of the minimal state (national defense, enforcement of justice) under the concept of public good. According to my reasoning, I can classify them as merit goods, since they are the condition for the possibility of the free market as a factual arrangement. Thus, contrary to most economists, I would not consider national defense or police protection as examples of *pure* public goods.

In my analysis of Adam Smith's thought, I implicitly encountered a significant ethical problem: the right of ownership. Adam Smith admits that the protection of the right of ownership is a governmental action taken for the advantage of the rich and to the detriment of the poor, or for the advantage of those who have property and to the detriment of those who do not (674). The question now becomes whether this economically necessary protection of property is ethically justifiable. Marxists answer that the right of ownership must be limited, more exactly, that the ownership of the means of production in the hands of private persons must be prohibited. Western democracies answer by giving non-owners other forms of security such as unemployment benefits, work accident insurance, the right of unionized protection of wages, and so on.[103]

We learned about a first kind of merit good from Adam Smith: the goods and services connected with the idea of the minimal state and justified by the fact that they are the conditions for the possibility of the free market.

The free market is not, as Adam Smith says, a natural phenomenon that would flourish if greedy and unenlightened kings did not interfere. The neo-liberals[104] draw attention to the fact that the free market is a vulnerable human institution. Many (if not most) participants wish to escape the rules of the free market because it theoretically prevents the use of power to increase the benefit from economic transactions (e.g., monopolistic practices). The endeavor to escape from the free market took a serious turn in the nineteenth century with the creation of cartels, trusts, and unions.[105]

The neo-liberals tend to look at the free market, not as a natural fact, but as a valuable human institution that succeeds in guaranteeing almost automatically the value of economic efficiency. The neo-liberals claim that the free market is worthwhile, because it promotes that efficiency. They are also prepared to claim that the government has to do whatever it can to make economic reality approach the efficiency that the theory of the ideal free market demonstrates to be possible.

In order to prevent individuals from escaping the discipline of the competitive free market, the state will have to impose measures that violate the Pareto principle. I call these measures the possibility conditions for implementing the ideal efficiency of the free competitive market. An important representative of the neo-liberals is Henry C. Simons, founder of the Chicago school and author of *Economic Policy for a Free Society*. In that

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[103] Hegel argued that property is a first and necessary objectification or embodiment of freedom. He thereby defends jointly the right to property *and* the philosophical necessity of overcoming poverty and destitution. I developed these ideas more extensively in chapter 3, Section III "The Proper Relation Between State and Economy" and in chapter 4, Section I "The Function of Property."

[104] The term "Neo-liberal" is a translation of the German term *Neoliberalismus*, and covers such diverse groups as the Vienna marginalists, the economists centered around the *Ordo* group in Freiburg/iBr, and the Chicago School of Economics. Egon Edgar Nawroth provides a splendid overview of the doctrines of different German neo-liberal authors (Nawroth 1961).

[105] Guilds, mercantilism or physiocratic policies all violated the laws of the free market. These violations occurred, however, before the defense and glorification of the free market by Adam Smith. The nineteenth century's practices, on the other hand, can be seen as a direct challenge to the presentation of the free market as normatively desirable.

work he assigns the government five groups of tasks, of which four are significant for us.[106]

First, Simons recommends two measures in connection with the monetary system. He suggests that the banking system should be based on an obligatory 100 percent reserve requirement instead of the fractional one presently in place. He also proposes that banks should lose the right to convert short-term debts into long-term ones. Both measures would limit the power of banks to create credit. Simons argues that this is necessary, because the creation of credit is a major cause of inflation, which deforms economic activity and leads to inefficiency (1973, 62-3, 78–9).[107]

Second, Simons argues that monopolies should be opposed by the government. Natural monopolies such as electricity, water supply, and so on have to be controlled by public authorities. Artificial monopolies have to be broken up. Production limitations and the creation of artificially high prices have to be legally treated as crimes. Buyouts of industries need to be legally limited. The creation of connections between related industries also has to be prohibited. Thus, the possession of stocks in other companies has to be limited, as does the possibility of becoming a member of the board of directors of another company (81–3).

Third, Simons attacks tariffs and subsidies, especially in foreign trade and agriculture. Only in the case of an "infant industry" does Simons accept the argument that a temporary subsidy is justified (69–70, 84).

Fourth, Simons recommends that a series of measures be taken to improve the efficiency of commerce. He claims that advertising is useless, and therefore he recommends that high taxes should be placed on it.[108]

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[106] Roughly the same governmental activities were argued for by a group of authors centered around the German journal *Ordo*, in Freiburg/iBr. The main theoretical representative of that school was Walter Eucken (1982, 115-31). The best known public figure of that group is Ludwig Ehrhard, who was credited with engineering the German economic miracle after the second world war.

[107] I am not alone in calling stable monetary policy a merit good. B. Molitor does so too, even though he calls it a different kind of merit good, i.e., security (1988). I classify security concerns (a social safety net) as a fifth kind of merit good and would also put there Molitor's other examples of protection against work related accidents and obligatory retirement savings. I believe that one needs different arguments to justify the government's role in monetary policy and in providing a social safety net. Therefore, I believe that I am justified in separating monetary policy and the provision of social security in putting them into different categories of merit goods. Finally, let us point out that Schumpeter, without using the word "merit good," stressed the great importance of money by making the banker together with the entrepreneur responsible for economic development (1969, 95–127).

[108] Currently the argument is made that advertisement provides economically useful services: it provides information and it helps new products find a quicker acceptance in the market. It is my opinion that it is within the spirit of Simons's argument that advertising that is economically useful should be allowed. On the other hand, I also believe that legis-

Furthermore, Simons sees no advantage in the protection of wholesale prices. He proposes that wholesale prices should be legally accessible to everyone. Finally, it appears to be important for Simons that consumers should be better informed. He advocates easily comparable price indications, and easy quality comparisons between different goods (72, 85 ff.).

Clearly, the neo-liberal program cannot be defended on the grounds of the public goods argument. Indeed, Simons does not respect the Pareto principle. He, in fact, makes it clear that he does not even intend to respect the wishes of those who through their activities diminish or distort the efficiency of economic activities. We are again confronted with a series of merit goods.

The neo-liberals defend their program with the argument that the competitive free market improves efficiency. A new question now arises: Is efficiency a value that one should pursue unconditionally? In other words, can one argue that efficiency is so important that it entitles the government to use its power to execute the neo-liberal program against the wishes of individual citizens?

What arguments are there available to defend the proposition that the government can *justly* impose the measures defended by the neo-liberals? In other words, what are the possibility conditions for the neo-liberal program to be just?

Here we can call on Kant again. Kantian ethics looks for the basis of ethical prescriptions, not in a religious faith in God, but in human reason. As maintained by Kant, living a moral life is living according to the moral law, in conformity with the demands of reason and out of respect for reason. Both Simons and his German counterpart, Walter Eucken, have presented their program as rational. Whether their proposals are defensible in their details is a matter of continuing debate. What is no longer debated by the majority of academic authors is that the government has a positive role to play in promoting economic efficiency by fighting inflation, regulating banking, and fighting monopolistic practices.[109] But academic authors are not the major group of economic actors who are affected by government regulations that promote fair business practices. Ideally, for Kant, restric-

lation requiring truth in adverting is similarly in agreement with the spirit of Simons's writings on advertisement.

[109] Of course, there is still a debate over the role of the government in economic matters. The debate now centers around the thesis that market failure is not enough to justify a role for the government. The "Public Choice" economists have argued that one must still prove that government intervention will not create bigger failures than the failures created by the market. However, arguing for a restriction in government tasks is, in effect, agreeing that there is room for legitimate government tasks even though some authors argue that the government should have no function at all in some areas, such as patent law.

tions on one's freedom should appear rational to those on whom the restrictions are imposed.

We are now ready to give an argument for the third kind of merit good. Rationality of the citizens is a precondition for the government being able to impose the measures advocated by the neo-liberals with the intention of reaching the efficiency promised by the free competitive market and having these measures accepted by their citizen-voters. How can we hope that the burdens required for the efficiency of the free market will be accepted if the citizens' rationality is defective? In Kant's opinion, rationality is the condition for the possibility of having binding values. But, this provides an argument for the support of education in as much as it improves the rationality of the citizens-consumers. Improvement of educational instruction for the whole population is therefore a third kind of merit good. This theoretically postulated third group of merit goods is not without its empirical confirmation. Christian Scheer has argued that the expansion of the public budget in the latter part of the 19th century in all Western societies was the result of the expansion of subsidies for education (1975).

Conclusion

The concept "merit good" refers to those economic activities of the government that cannot be justified by the idea that these activities help consumers achieve the satisfaction of their wishes. Such activities are captured by the concept of public good. Merit goods can be justified, though, by a Kantian method of reasoning. They can be justified as the necessary conditions for the possibility of what the citizens of a free market wish.

I have defended three kinds of merit goods: those that are connected with the minimal state, those which are connected with the neo-liberal program, and those merit goods that are connected with the improvement of the exercise of reason, namely education.

These three types of merit goods are not the complete series. Reason requires more than micro-economic efficiency. It requires macroeconomic efficiency across the business cycle, justice, and human dignity. This is precisely what the contemporary welfare state tries to do with its economic stabilization programs, its redistribution efforts, and its social programs such as unemployment compensation measures and social security arrangements.[110] For these measures I do not give arguments here.[111]

I believe, however, that I have given ethical thinking an essential place in economic theory by providing a method for the justification of the concept of merit good, which was first introduced by the public finance economist Musgrave. By maintaining the validity of the concept of merit good, I thus distinguish myself from economists who have tried to reduce the concept of merit good to characteristics belonging to the concept of public good.[112] My theory is also different from the theory of sociologists who use social habits as a category to explain the difference in the provi-

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[110] Many of the examples given by Musgrave are cases of redistribution in kind or categorial redistribution (obligatory education, free school lunches, subsidized housing, subsidized or free inoculation) and would thus have been treated in that part of the argument.

[111] I do that in an unpublished book-length manuscript on merit goods with the tentative title: *Private, Public and Merit Goods*.

[112] John G. Head wrote three magnificent articles on the merit good problematic. He is ultimately not able to maintain the difference between public and merit goods because he emphasizes preference correction as opposed to preference interference as the defining characteristic of merit goods (1966; 1969; 1988). In the latter article, we find the following: "This whole line of argument clearly suggests, however, that all social wants problems can in a fundamental sense be characterized as generalized merit wants problems involving a hierarchy of 'higher' and 'lower' preference orderings in combination with impulsiveness or weakness of will" (30). For me, public and merit goods need to be justified in a totally different way. The idea of interpersonal utility interdependence, too, is used by some to connect public and merit goods (Culyer 1971; Brennan and Lomasky 1983; Brennan 1990). My thought is that the merit good idea would require, for instance, more redistribution than interpersonal utility interdependence can justify. Interpersonal utility interdependence can only justify part of what the merit good idea intends to justify. It therefore remains important to continue to distinguish merit and public goods.

Another way to defend the usefulness of the distinction between public and merit goods is by means of contemporary epistemology. Contemporary epistemology argues that all human insights are limited. One author captures that insight very pictorially by calling all human insights "angular truths" (Desan 1972, ch. 3). Some economists reduce or hope to reduce the problem of merit goods to matters of lack of information, wrong information, or irrational decisions. Such a view overlooks the angularity of all human insights. When I make decisions about buying computer software, it is not possible to hope that I as an individual could consider the monopolistic aspects of software sales techniques. It is for others who are better placed to make such analyses, e.g., the anti-trust division of the Justice Department. In my view, as in the view of Desan, it is irrational to expect from human insights more than is reasonable. This opens the door for epistemologically justified conflicts between individuals and supra-individual organizations. This does not mean that when there is a conflict the supra-individual organization is always right. It means that one needs to recognize the existence of real conflicts. The concept of merit good captures such conflicts.

An author who understands very well the difference between the concepts of public and merit good and who, furthermore, understands the ethical dimension of the concept of merit good is Birger P. Priddat (1992; 1994).

sion of merit goods in different societies.[113] Finally, my theory is different from the theory of those economists and political scientists who are looking to a proper political process (democratic constitutional policies) as the justifying mechanism for the imposition of merit goods (Mackscheidt, 1974; Brennan & Lomasky, 1983; Brennan, 1990).

A positive result of my view of merit goods is that I am able to create a conceptual space for the writings of economists who deal with fairness, subsidies, and financing methods of morally worthwhile projects (Buchanan, 1983). A further positive result is that I am able to distinguish between public goods and goods defended in the political arena by value arguments. Values provide arguments that justify overruling the wishes of individuals and must therefore be located elsewhere than in the public good discussion. If value arguments, stripped of the aspect of public goods, have a kernel of validity, it is as merit good arguments (e.g., hardened criminals must be executed; public education must be done by vouchers).[114] A further positive result of my view of the concept of merit good is that institutional economic arrangements can be seen as economic activities for which there is a conceptual home in pure economic theory. Institutional arrangements violate the wishes of some economic actors (e.g., in antitrust legislation) and thus exhibit the characteristic that defines the category of merit good. No economic activity should be without a conceptual home. However, my view of merit goods is that it houses many more economic activities than Musgrave imagined.[115]

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[113] Cay Folkers very properly stresses the societal preferences at work in merit goods (1974). That societal preferences are not always congruent with individual preferences indicates the presence of claims on resources that do not fit into the consumer sovereignty tradition. Still, for me, the question remains whether or not Folkers's claim might not have a more solid justification than the simple statement that merit goods are the expression of social habits.

[114] Malkin and Wildavsky argue that the traditional distinction between public and private goods should be abandoned (1991). The authors write: "We have seen that it is impossible to develop a definition of public goods that rests on the technical properties of the thing itself. We have also seen that it is impossible to justify government financing of public goods in a value-free manner. The flaws in public goods theory allow economists to promote their personal values under the guise of economic 'science'" (372). By maintaining both the concept of public and merit good, one can refute the objection of these authors against the concept of public good, because the presence of value judgments overruling personal preferences is by definition a merit good.

[115] In his interpretation of the concept of merit good, which includes a partial redefinition, Klaus Mackscheidt observes that the concept of merit good is applicable to domains not envisioned by Musgrave (1981, 264). Bruno Molitor makes use of a characteristic of German language to systematically broaden the applicability of the concept of merit good. German language allows for the creation of a verb *meritorisieren* (making meritorious) and a noun from that verb *Meritorisierung* (the fact of declaring something meritorious). Molitor thus argues for making the whole area of security a merit good concern for the gov-

Finally, my view of merit goods provides the opportunity to explain certain anomalies. Take the case of education. Many economists call education a public good. The paradox is that the local tax contribution for public elementary and secondary schools in the United States is financed for 96% by property taxes.[116] Typically, young couples with children do not possess the largest, most expensive homes. These are sometimes owned by childless couples or couples whose children are grown. Labeling education a public good means that the government has an opportunity to help consumers achieve the fulfillment of their wishes by collecting from everyone what they want to pay for the service in return for the provision of that service. Providing education as a public good therefore requires that the government only collect what individuals feel the service is worth to them. (The government is allowed to disregard strategic bargaining and free-rider strategies.) The provision of education as a public good thus requires that the government make individuals pay in proportion to their benefit. However, the actual financing method of education, violates this rule. Couples without children but with expensive homes are forced to pay more than couples with children and less expensive homes. If education can only be justified as a public good then, conceptually speaking, some people are forced to pay more than they should, while others are allowed to pay less than they should. Using force in order to make someone pay more than he should could be called theft. But, the government uses its taxation power to force some people to pay more than is conceptually justified. Calling education a public good exposes its current financing methods as theft.[117]

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ernment (1988). Molitor's approach allows for two generalizations not present in Musgrave's texts. Molitor can ask the question: what are the conceivable subfields for providing the merit good category "social security?" Molitor can also ask the question: what are the conceivable techniques that the government can use to promote a whole category of merit goods? In a later publication (1989, 59) he creates the concept "Meritorisierungsinstrument" (means for approaching a good as a merit good). Thus Mackscheidt and Molitor develop a problem that is much broader than the one addressed by Musgrave when he asks the question of how one can defend single cases of merit goods such as free school lunches, subsidized housing, subsidized medical care etc. I therefore feel that both Mackscheidt's and Molitor's writings vindicate my approach of expanding the concept of merit good according to its inherent philosophical dimension.

[116] Figure is for 2001–02. See publication by US Census Bureau: *Public Education Finances: 2002.* http://ftp2.census.gov/govs/school/02f33pub.pdf, Table 4, p. 4.

[117] David Schmidtz (1991, XVI,159) makes a similar point when he argues that the public goods argument does not entail the right of the government to use coercion. If coercion is to be justified additional arguments need to be given such as survival of society or equality. Schmidtz seems to be sympathetic to the argument of survival and grants that others might want to make the argument of equality. In both cases a solid value argument is needed for justifying coercion. Schmidtz therefore argues, as I do, that the use of coercion in the provision of public goods can only be justified as a merit good. That requires a different kind of argumentation than the public goods argument.

In my view, education is partially a public good and partially a merit good. As a public good, it is proper that the ones having the most immediate benefit pay the most. This is the case where public colleges request tuition from students. The citizens of the state all benefit from a literate and educated population. (In a literate population my medical prescriptions will not be easily misread and I will not have to pay exorbitant fees for my pharmacy to hire a literate clerk who can read my prescriptions. In a literate population the chances of having an illiterate son- or daughter-in-law are slim, which I assume to be a desirable state-of-affairs for all parents.) Thus, all citizens may be asked to contribute to financing education. Still, this argument does not allow the state to charge some individuals out of proportion to the benefits they receive. Using property taxes to finance education does tax some individuals out of proportion to the benefits they receive. Since the concept of public good does not justify such a method of financing, the government should either abandon that method or look for another justification. Calling education partially a merit good would justify such a financing method. Indeed, ability to pay has been a financing method defended for merit goods. Property taxes can be considered taxes levied according to the ability to pay method.

The example of education illustrates one last important aspect of my theory of private, public, and merit goods. In my view these three concepts are all ideal concepts.[118] They are more or less realized in all goods. Thus, in my view, it is incorrect to ask whether a particular good is a private, public, or merit good. The proper question to ask is which *aspects* of a particular good exhibit characteristics typical of the concept of private good, of the concept of public good, and of the concept of merit good.[119]

[118] Paul Samuelson introduces the idea of an ideal concept for public goods in defining it as "*consumption goods* . . . which all enjoy in common in the sense that each individual's consumption of such a good leads to no subtraction from any other individual's consumption of that good" (1954, 387). In a subsequent paper Samuelson defends what I take to be an ideal concept interpretation of the term "private good," while presumably retracting his ideal concept interpretation of the term "public good." Consider: "What are we left with? Two poles [the ideal concepts of public and private goods] and a continuum in between? No. With a knife-edge pole of the private-good case, and with *all* the rest of the world in the public-good domain by virtue of involving some 'consumption-externality'" (1969, 108, including footnote 2). Musgrave clearly sees the ideal type argument in Samuelson's concept of public good (1969, 124, 126–34, 142). I do not see Musgrave as explicitly conceiving his own concept of merit good as an ideal concept.

[119] Birger P. Priddat argues that every public good voted for by a majority against the will of a minority must be considered as having a merit good aspect for the minority. This merit good aspect often relates to the financing system disliked by the defeated minority. He thus implicitly holds two of the theses that I hold: first, a good can be both a public and a merit good and second, the concepts of public and merit good are ideal concepts that apply to aspects of concrete goods (Priddat 1992, 246).

Take the example of bread. Most economic textbooks take bread to be a private good. I would say that the governmental requirement of providing printed information about the nutritional content is an interference with the choices of producers.[120] That requirement must therefore be justified as a merit good aspect in the provision of bread. Similarly, the governmental prohibition against using sawdust to increase fiber content is again a governmental interference. That I now have bread without sawdust or bread with content labels printed on the package is not the result of market forces mediating the wishes of consumers and producers. It is the result of governmental interference. Bread is thus not a 100 percent private good. It has private good aspects as well as merit good aspects. Calling the concepts of private, public, and merit good ideal concepts is not just a matter of philosophical sophistication (of course it is that, too). Seeing these three concepts as ideal concepts will allow economists to correctly describe the

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Norbert Andel gives a different interpretation of the facts that Priddat and I observe. He sees an interference in both merit and public goods and thus prefers to conceptually group public and merit goods into one theoretical group: those goods where there is market failure (Andel 1968/69, 212–3). But Andel provides the observation necessary to maintain the difference between public and merit goods when he writes: "What can be said with reference to merit wants is also true for some public goods." But if something is true for *all* merit goods while it is true only for *some* public goods, then there must be a conceptual difference between public and merit goods. This is what I maintain, while allowing for the fact that concrete goods may be both public and merit goods.

Klaus Mackscheidt, also, observed that public goods sometimes have characteristics typical of merit goods. In order to limit the cases of goods that are both public and merit goods, Mackscheidt restricts his definition of the concept of merit good by excluding interferences with individual preferences resulting from a democratic majority imposing its will on a minority for purposes of providing a public good. Still, Mackscheidt explicitly preserves the two concepts of public and merit (1981, 262–4). In a recent letter, Mackscheidt discusses situations where a public good (successful inoculation against infectious diseases) cannot be provided without meritorisation of the public good (provision of subsidies). He thus reaffirms the idea that the concepts of public and merit good are different. However, he differentiates the two concepts not purely on the basis of the ideas they capture, but also on the basis of their extension. Thus Mackscheidt demands from a merit good that it be a good that is not just a public good, but a private good as well (1997). My view is that the concepts of public and merit good (and the one of private good as well) can be defined by their ideational content. The question of how many of the concepts apply to one concrete economic event is not immediately part of the conceptual problem. This is the state of affairs not only for the concepts of private, public, and merit good but also for those of a beautiful, just, and good person. In this latter case, philosophers are not bothered by the fact that a human being can be labeled either beautiful, good, or just or a combination of them. If it is acceptable that a person can be beautiful, good, and/or just, why is it problematic if concrete economic events are called simultaneously private, public, and/or merit goods?

[120] The positive justification for such government imposed information is to make informed consumer choice more possible and also to diminish, what common sense would consider, fraudulent practices.

facts (what kind of a good is bread?) and will allow economists to provide a justification for methods of taxation which, like current methods of financing education, would otherwise have to be rejected as disguised theft.