12 Welfare and Well-Being

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Overview

This chapter will introduce welfare economics, look at its normative foundation and discuss alternative proposals for one of its core ideas: its conception of well-being. (This is a philosophers' term. Economists usually refer to the same thing as "welfare." "Welfare," however, also means "social support," so I will use the philosophers' term in what follows.) Theories of well-being are highly controversial. That this should be so is not hard to see. Well-being measures, roughly speaking, how well a life is going for the person leading it. That different people, coming from different social and cultural backgrounds, should have different ideas of what that means is not surprising. Nor is it surprising that philosophers, who value abstract and universal theories, do not easily find a fully adequate theory.

And yet, we cannot avoid theorizing about well-being. Normative economics cannot do without the concept, nor can moral and political philosophy. Below I will sketch an understanding of the various theories of well-being on offer that minimizes the substantial commitments the normative economist has to make. But minimal is not none, and to get there we have to get an idea of what is at stake in the debate about well-being.

Welfare Economics

Welfare economics uses microeconomic techniques to evaluate the consequences of economic institutions for individuals' well-being. What most former students of economics will remember from welfare economics is that its crowning achievement is the proving of two "fundamental theorems." The "First Fundamental Theorem of Welfare Economics" states that any Walrasian equilibrium is Pareto-efficient. The "Second Theorem" states that any Pareto-efficient allocation can be realized as a Walrasian equilibrium as long as transfers of initial endowments are possible. Walrasian equilibrium and Pareto-efficiency are the key terms here. They are defined as follows (cf. Varian 1992: ch. 17; Mas-Colell *et al.* 1995: ch. 10): a Walrasian equilibrium is an allocation of goods and a vector of prices at which all consumers maximize utility (firms maximize profits) and all markets clear—that is, that there is no excess supply or excess demand. A Pareto improvement is a change from a given allocation to a new one such that the new allocation is preferred by at least one agent and no one prefers the old allocation. An allocation is Pareto-efficient if there are no possible Pareto improvements.

One important condition for the theorem to hold is that preferences are locally non-satiated. That is, for any consumer and any bundle of goods, there is always another bundle of goods arbitrarily close to the first, which is preferred by the consumer. This assumption is similar to the assumption of monotonic preferences—preferences are monotonic if more of a good is always preferred—but weaker and therefore better.

Put this way, the first fundamental theorem is trivial. If people choose the consumption bundles they prefer most given their budget constraints (they are utility maximizers), if there is always some bundle of commodities in the economy they would prefer (they are locally non-satiable) and all goods have been allocated already (markets clear), then it must indeed be the case that one cannot reallocate the goods in a way that there is not at least one consumer who would prefer the current allocation (the current allocation is Pareto-efficient).

The theorem gets some bite, and with that, notoriety, only when two amendments are made. First, Pareto-efficiency is equated with some kind of "optimality." Specifically, it is assumed that a Pareto improvement is a (morally and politically) good thing. Daniel Hausman and Michael McPherson call this assumption the "Pareto principle" (Hausman and McPherson 2006: 136, 218). Value judgments have thereby entered the argument: preference satisfaction is identified with well-being, and to increase people's well-being is judged a morally and politically good thing. Second, it is shown that under some—this time, far more restrictive—conditions, free markets lead to an equilibrium allocation of goods. The conditions under which a free market leads to an equilibrium allocation include price-taking behavior by everyone (which has some plausibility when there are many firms and many consumers), perfect information and that there are markets for all goods. Both amendments are highly controversial. Figure 12.1 summarizes the structure of the argument.

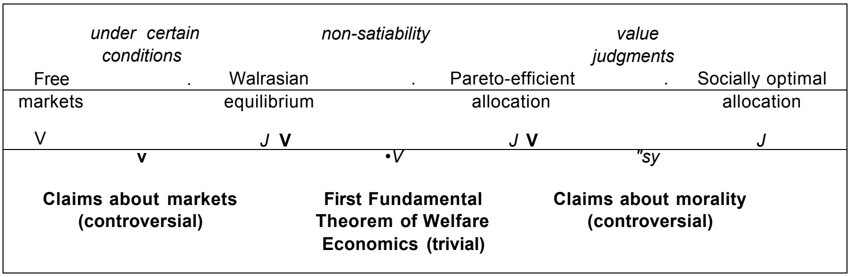

Figure 12.1 Arguing from Free Markets to Social Benefit

The first fundamental theorem of welfare economics is often alleged to be a version of Adam Smith's "invisible-hand" argument. In *The Wealth of Nations*, Smith (1904 [1776]: book IV, ch. 2) wrote: "Every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it ... He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention." That end, of course, was some sort of socially (rather than merely individually) desirable outcome.

Another way to put Smith s claim is that ¿/people pursue their self-interest, then free markets will lead to a socially desirable outcome. Let us call this claim the "invisible-hand hypothesis." We see here that the invisible-hand hypothesis contains the fundamental theorem only as a small part. The more interesting and controversial elements are claims about how free markets operate and how to evaluate market outcomes. This chapter is concerned with whether to satisfy someone's preferences means to make him or her better off, that is, whether it promotes the individual's well-being. Markets will be examined in more detail in Chapter 13. Whether the promotion of well-being is the *only* moral and political good will be the subject of Chapter 14. Finally, to what extent people really pursue what is in their self-interest will be discussed in Chapter 15.

Well-Being

General Remarks

The invisible-hand hypothesis assumes that the satisfaction of an individual's preferences makes the individual better off. To make someone better off means to enhance her *well-being*. In ordinary language, when we talk about a person's well-being we talk about her health, her happiness or her "milk and honey." These are related to the philosopher's concept, but the philosopher's concept is technical and abstract. According to the latter, a person's well-being is that which is *ultimately good for her* (see for instance Crisp 2008). All three aspects: "ultimately," "good" and "for her" are essential to that concept.

"That which is *ultimately* good for her" expresses that theories of well-being focus on what is intrinsically, not what is instrumentally good for a person. A "wealth theory of well-being" would be a contradiction in terms because wealth is always at best instrumentally good. A person's wealth enables him to purchase and consume more goods and services, to be more autonomous, to have a greater influence on the world around him, to live a healthier life and, perhaps, to be happier. But it is these latter things we care about, not wealth as such.

What is true of wealth is in fact true of most things economists talk about. If wealth enables us to buy goods and services, many of these goods and services are themselves not intrinsically but rather instrumentally valuable. We do not buy and consume an apple for the apple's sake but because it nourishes us and makes us happy and satisfied. As there is no wealth theory of well-being, there is no apple theory of well-being. Well-being is something we *ultimately* care about.

Another aspect of this dimension of the concept of well-being is that it is evaluated over a person's entire lifetime, not as a momentary glimpse. Eating lots of *foiegras* may be good for me for every point in time but not for my life as a whole because it will eventually make me sick. We will see later that various paradoxes and counterexamples to theories of well-being hinge on this aspect. But that this should be so is clear from the role well-being plays in various ethical theories. If the Tightness or wrongness of actions depends on its consequences on people's well-being (utilitarians think that *only* the consequences on well-being matter for moral evaluation) and the consequences unfold over time, it is certainly important to look at all the consequences of an action, and not only those pertaining to a single point in time. Similarly, if the Tightness or wrongness of a socio-economic policy is evaluated with respect to its effects on people's well-being, the evaluation should not be myopic.

"That which is ultimately *good* for her" expresses that well-being is an evaluative term. There is no descriptive theory of well-being. We cannot talk about well-being without making value judgments. We will see below that economists subscribe to a formal as opposed to substantive theory of well-being. That is, they tell us how to go about finding out what is good for people, but not what this good ultimately is (Hausman and McPherson 2006: 119). Economists are inclined to believe that only individuals know what is best for them. Therefore, economists should not have substantive views about the conception of the good. But this is of course to make a moral judgment and to subscribe to a particular theory of well-being: namely, well-being is what people desire. One can have an alternative theory of well-being—for instance, that health is good for people independently of whether they desire it or not—but one cannot have a theory of well-being and abstain from value judgments.

"That which is ultimately good *for her*" expresses that well-being concerns an individual's *personal* good and not what is good for others or animals or nature or deity. Most of us care deeply about other people's well-being. We care about our children and future generations, about relatives and spouses, countrymen and supporters of our values, about the human race, about animals, nature, God and abstract ideas. But these considerations count towards our well-being only insofar as they affect us, for instance, through the joy experienced by seeing one's children doing well.

So much for the general conceptual remarks. Substantially, there are three families of theories of well-being. The first is the one we have already encountered. It is endorsed by many economists and by a number of contemporary philosophers; the second, by contemporary psychologists (as well as some dead philosophers and living economists); the third, by other contemporary philosophers. There is no satisfactory theory, and this area of philosophy is a highly disputed one where agreement is largely lacking. The problem for a philosopher of economics is that one cannot just leave the formation of a conception of well-being to the individual because well-being matters for moral evaluation and political decision-making. As we will see in Chapter 14, there is a view in moral philosophy which holds that well-being is all that matters morally (and politically): welfarism. This is probably an extreme view, but to hold the opposite view—that well-being does not matter at all—is probably just as extreme. So we should know what theories there are, what makes them plausible and what their drawbacks are.

Well-Being and the Satisfaction of Preferences

In Part I we saw that rational-choice theories play a double role in economics: a descriptive role in explaining and predicting choices and a prescriptive role in vindicating certain choices as rational. In welfare economics and moral philosophy, these theories play a third role: they give an account of a person's well-being. The preference-satisfaction theory of well-being simply identifies well-being with the satisfaction of preferences. There are several versions of this theory. Here I will consider an actual preference and a laundered preference view of well-being.

Actual Preferences

If we take, as many economists do, the satisfaction of actual preferences as constitutive of well-being, we can cash in on a virtue of this theory: well-being in this sense is measurable relatively unproblematically. If people choose what they prefer and they prefer what is better for them, then well-being can be measured by observing people's choices. But as we saw in Chapter 4 and will discuss at greater length in Chapter 15, people do not always choose what they prefer. Let us focus here on whether what people prefer is good for them.

It is quite clear that people sometimes make bad choices. Two-thirds of Americans aged 20 years and older are overweight or obese. Many of these cases would be preventable by a healthier diet and more exercise. Obesity is associated with many of the leading causes of death in the USA, including heart disease, several kinds of cancer, stroke and diabetes. About 12 million French people, a fifth of the population, are smokers, and more than 70,000 people die in France every year from smoking-related illnesses (Sciolino 2008). Many of these deaths may be premature in the sense that had people known better, thought things through more thoroughly or exerted more willpower, they would have chosen differently

Bad choices are made for at least three reasons. First, people are misinformed about the objects of their preferences. In the afternoon, I prefer black coffee with no sugar when it's quite good coffee, white coffee with no sugar when it's so-so, and white coffee with sugar when it's really bad coffee. There have been occasions where I mistakenly assumed coffee was good and (literally) bitterly regretted my choice once I had tried it. I may have had perfectly "rational" preferences (in the sense of being able to rank available options in a way which tracks my well-being, and I chose the highest-ranking option) but I was ill-informed and thus chose badly on these occasions. Second, I may have a perfectly well-informed preference but for whatever reason fail to act on it. One source of such a failure to act on one's preferences is weakness of will, called *akrasia* by the Greeks. Third, I might prefer states of affairs that do not affect my well-being or that make me worse rather than better off. If I was a bodyguard and threw myself in the line of fire to protect my client, I may do so entirely deliberately and fully informedly but without promoting *my* well-being.

If people do not always choose in ways that are good for them, there must be more to well-being than actual preferences. It is important to see that it is not even necessary to have evidence that actual people sometimes make bad choices. For the actual-preference theory of well-being precludes the conceptual possibility of people preferring what is not good for them. But that is quite implausible. Some philosophers have therefore proposed that preferences undergo a process of cleansing before they are counted as advancing well-being. Ill-informed and inconsistent preferences are meant to be ruled out in this way. The result is called an "informed," "rational" or "laundered" preference ordering (e.g., Arneson 1990; Gauthier 1986: ch. 2; Goodin 1986; Griffin 1986).

Laundered Preferences

To conceive of well-being as the satisfaction of laundered preferences of course eliminates a major advantage of the actual-preference theory: the relatively straightforward measurability of the concept. We can observe only how people actually choose, not how they would choose if they were fully informed, rational and possessed infinite amounts of strength of will. At the same time this move away from an operationalizable concept brings with it increased plausibility. That people sometimes make bad choices is allowed by the theory, for instance because they do not know everything that is relevant for making welfare-enhancing choices.

There remain three problems, however. One has to do with the fact that (fully informed and rational) people do not always prefer what is good *for them*; another, with the fact that they do not choose what is *ultimately* good for them; and a third, with doubts that even fully informed people choose what is *good* for them.

Most people have other-regarding preferences alongside their self-regarding preferences, even when fully informed and upon reflection. We have preferences concerning our families, neighbors and society at large, about our elders and generations to come. People's decisions to donate money to earthquake victims do not directly benefit them. Leonard Sumner (1996: 132ff.) pointed out that the identification of well-being with the satisfaction of (laundered) other-regarding preferences involves a conundrum that is similar to one discussed above: self-sacrifice is conceptually impossible. On November 21, 2011, Jenni Lake, a teenager from Idaho, died of cancer just days before her eighteenth birthday. She had stopped chemotherapy and radiation treatments to avoid terminating her pregnancy, and gave birth to a healthy baby 12 days before she died (ABC News 2011). Whatever is true of this particular case, it would be odd if we could not describe the teenager's decision to forgo treatment as one of self-sacrifice for her child. But on the (laundered) preference-satisfaction view, the satisfaction of her preference of no treatment/premature death/delivery of a healthy child over treatment/deferred death/no child would necessarily constitute an enhancement of *her* life, which is implausible.

Preference *changes* also induce problems. Someone may make a clear-headed decision to take a highly addictive drug for the first time but thereby practically enslave his future selves. That the satisfaction of these preferences should be well-being promoting is at least dubious (cf. Crisp 2008). The problem manifests itself particularly when decisions have externalities (as in the drug-addiction case or when preferences are sadistic).

That conflicts can arise when earlier selves try to commit later selves is easy to see. Carolus Van Cleef, hero of Kyril Bonfiglioli's novel *All the Tea in China,* had a bad hangover after an overdose of opium. Once he felt better he told his servant-boy, "You":

> Do you see these two sixpences? Now, hold, one of them is for you, to spend on nourishing food. The other you are to hide, "You," and the next time I bid you go out and buy me opium, either tincture or the lump, you are to take that sixpence into the street and hire a hulking carter, drayman or vegetable porter from the market and bid him come in here and beat me about the head until I fall unconscious. This will be both cheaper and better for my health. Is that clear?
>
> (Bonfiglioli 2008: 57)

Suppose after a passage of time our hero indeed sends "You" out to buy opium for him. Which preference should he satisfy, the current or the earlier?

In the present case we are inclined to give the earlier preference priority. But many commitments we make may later sound foolish to us. Suppose a friend of yours, at age 50, paid a hired gun to kill her or him in 10 years (after careful deliberation and being informed comprehensively about all the options, of course). If your friend, upon turning 60, truly desires to live for another 10 years, it is not at all clear that the satisfaction of the earlier preference would have made her or him better off.

When the reason for evaluating people's well-being is economic policy, the problem of changing preferences and, more specifically, endogenous preferences becomes particularly acute. Policies often influence people's preferences. Though probably no amount of confrontation with pictures of the cancerous lungs of hapless smokers will suffice to make everyone stop smoking, one of the aims of this campaign is to change smokers' preferences. But if social policy aims to promote people's well-being and that consists of satisfying their post-policy preferences, many successful policies will justify themselves because they will make it true that people prefer the state of affairs the policies bring about (such as being a non-smoker). Consequences of a policy will often unfold over time. If they do, and people's preferences change over the course of their unfolding, we have three sets of preferences to choose from: the initial pre-policy preferences, the intermediate preferences and the long-run preferences.

Finally, there are some doubts that people prefer what is good for them. One potential counterexample comes from John Rawls. He considers someone whose only (perfectly informed and thought-through) desire is "to count blades of grass in various geometrically shaped areas such as park squares and well-trimmed lawns" (Rawls 1971: 432). One might want to argue that the grass-counter's life could be improved by frustrating her preference and forcing her to pursue the greater things in life such as playing the piano, becoming an art collector and a connoisseuse of fine dining and old wine. But is it clear that frustrating a person's preferences can be a good thing for the person?

In an episode of the TV series *Frasier* the radio psychologist faces just this dilemma. One day he notices that a tape from his precious collection of recordings of his past shows is missing. He asks on air whether one of his listeners recorded the missing show, and, lo and behold, someone calls in. Visiting the caller to pick up the tape, Frasier finds out that his fan, Tom, is completely obsessed with him. Not only has Tom listened to every show from day one, he records all shows to listen to them a second time, he transcribes the shows, and he boarded up the sole window of his apartment just so he could hang up more autographed pictures of the radio personality. After hearing that Tom quit his job in order to be able to fully devote himself to his passion, and following an exchange in which Frasier explains that the purpose of his show is to help people live better lives, to which Tom rebuts that he is fulfilled as it is, Frasier says: "Tom, what I'm getting at here is I think that there could In more to your life than just my tapes and pictures. Now, if you'd be interested in exploring those issues further, I can recommend someone who'd be glad to talk with you." Tom replies: "Why? I have you!"

Some of us might find it difficult to tell Tom and Rawls' grass-counter that their lives are going badly for them. Many people devote much of their lives to a cause. When they are a Mother Teresa or cancer researcher, we admire them; Tom and the grass-counter, on the other hand, are supposedly lacking something. Some of us might think such an attitude patronizing.

A more convincing objection is that it seems implausible that the satisfaction of preferences about which the owner of the preference does not know and that does not affect him in any way should constitute a well-being enhancement for that person. We have many preferences of that kind. Most people will prefer that the global mean surface temperature in 2100 will be the same as today's to it being five degrees higher—but few people who have the preference will see that day. Some of us prefer God to exist and others that racism be false. Somewhat more concretely, we may wish that a stranger recover from an illness but lose touch and never find out if he did (Parfit 1984: 494). According to the preference-satisfaction view a low temperature in 2100, an existing God, the falsity of racism and the stranger's recovery are all things that make our life go better, but it is hard to see how this should be so if we do not or cannot learn about the satisfaction of our preference.

Preference Satisfaction, Morality and Policy

Thus far I have considered the preference-satisfaction theory mostly independently of context. When we examine the theory in the contexts of moral evaluation and social policy, additional difficulties arise. Sadistic and other anti-social or perverse preferences pose problems in these contexts. Let us call any preference whose satisfaction harms other individuals "malevolent." Suppose Rawls' grass-counter by and by becomes bored with his grass-counting and develops a taste for cutting wings off butterflies. One might say that satisfying this preference promotes his well-being. But actions tbat promote well-being in this sense are hardly praiseworthy from a moral point of view. Nor does it seem that policies should be evaluated on the basis of their effects on well-being in this sense. We will discuss welfarism, the moral theory which holds that well-being is the only source of justification for moral claims, in Chapter 14. But it is clear that welfarism is a non-starter if well-being is understood as preference satisfaction, and preferences may be malevolent. Thus, to the extent that the concept of well-being is to be used for moral and political evaluation, the existence of such preferences counts against the view of well-being as preference satisfaction. The process of laundering preferences may get rid of some malevolent preferences but it would be Utopian to assume no one would hold malevolent preferences after being informed about the consequences and thinking hard.

The so-called problem of expensive tastes (e.g., Keller 2002) is similar. Someone who is "desperate without pre-phylloxera clarets and plovers' eggs" requires many more resources than someone who is "satisfied with water and soy flour" (Arrow 1973: 254). There is surely nothing intrinsically bad about having or cultivating expensive tastes. But if social policies are to be evaluated in terms of their consequences on well-being, it would seem unfair to regard all preferences on an equal footing, especially when people are to some extent responsible for their tastes. To the extent, then, that policy evaluation uses exclusively information about well-being, a different concept is needed.

These difficulties for a preference-satisfaction theory of well-being—changing, endogenous and other-regarding preferences, and states of affairs we wish obtained but whose obtaining does not affect us, malevolent and expensive preferences—are often regarded as quite damaging (see for instance Sumner 1996; Hausman and McPherson 2006, 2009). This does not mean that they are necessarily insurmountable. But they cast doubt on the idea that preference satisfaction should be *constitutive* of well-being. We will later see that this is not the end of welfare economics as we know it because there are views that see preference satisfaction and well-being as related, albeit not as closely as by the relation of identity. First, however, let us examine the main contenders in the preference-satisfaction view: hedonism and objective-list theories.

Hedonism

Hedonism is the theory that well-being consists in a mental state such as pleasure or happiness. Hedonism is a truly ancient theory of well-being, having been discussed in Plato's *Protagoras* first. It is the view of well-being that underlies the classical utilitarianism (see Chapter 14) of Jeremy Bentham (1907 [1789]), James Mill (1986 [1823]) and John Stuart Mill (1963b [1861]) and Henry Sidgwick (1874), though the four had different views of what mental states are regarded as constitutive of well-being. The view has recently undergone a small rejuvenation in economics (Layard 2005; Kahnemann and Krueger 2006); it has been experimental psychologists' conception of well-being for quite a while (see Angner 2009).

Jeremy Bentham's is the simplest and best-known account. It holds that well-being is the balance of pleasure over pain (1907 [1789]). All pleasures are of a kind, no matter what they are derived from—riding a motorcycle, swallowing an oyster, admiring a painting, reading a thriller. Pain is simply negative pleasure.

Hedonism is an initially plausible theory of well-being: pleasure is surely something that is good for us, even ultimately so. Many of the counter-examples to the preference-satisfaction view are easily accommodated by hedonism. If Parfit's stranger recovers but I don't know about it, I will not experience pleasure, and my well-being will not be enhanced. By contrast, the satisfaction of many other-regarding preferences may well affect one's well-being *qua* the pleasure the satisfaction of the preference yields. Thus, if I prefer my grandchildren to do well at school and my grandchildren do well at school, my well-being may be enhanced. If it is, according to hedonism this must be because I learn about my grandchildren's doing well, and that gives me pleasurable feelings. As we will see in a moment, this theory's catch is that the pleasurable feelings improve my well-being independently of whether my grandchildren are indeed doing well.

There are difficulties, of course. One set of issues has to do with the idea that all pleasures are regarded as on equal footing. Our experiences of riding a motorcycle, swallowing an oyster, admiring a painting, reading a thriller are all very different. Perhaps it is the case that with every pleasurable experience another mental sensation is associated, and that's what we call "pleasure." Thus, when looking at a painting, I don't only experience the painting; I have a second experience, namely of pleasure of a certain degree. 'Ihat secondary experience is what is common to all pleasurable primary experiences.

From a moral point of view, different pleasurable experiences should count differently. Crisp makes the point with a thought experiment:

> Imagine that you are given the choice of living a very fulfilling human life, or that of a barely sentient oyster, which experiences some very low-level pleasure. Imagine also that the life of the oyster can be as long as you like, whereas the human life will be of eighty years only. If Bentham were right, there would have to be a length of oyster life such that you would choose it in preference to the human. And yet many say that they would choose the human life in preference to an oyster life of any length.
>
> (Crisp 2008)

John Stuart Mill tried to get around that problem by distinguishing lower- and higher-level pleasures (1963b [1861]: ch. 2). But, arguably, this is a move away from hedonism. At any rate, there is a more decisive objection to hedonism: Robert Nozick's "experience machine" (Nozick 1974: 43).

Nozick imagines an individual living in a Matrix-like world. This individual has all the experiences one may wish to have: to ride an Aprilia across the Italian Riviera, to swallow a Belon oyster in the company of Chloe Sevigny or George Clooney (you choose), to admire a Gustave Courbet painting, to read a Robert Wilson thriller. However, these experiences aren't the product of your life circumstances and choices but those of the Matrix. Would you opt into such a life?

Ihere are further issues. Amartya Sen (1999b: 162) mentions the problem of mental adaptation. Individuals who have grown up into living a certain kind of life may experience pleasure rather than pain even though viewed from outside their lives appear miserable. Happy slaves, suppressed women and members of lower castes may be cases in point. There is also the converse possibility that one adapts to circumstances of affluence and thereby fails to appreciate one's privilege. Sen's main point about mental adaptation is that other considerations apart from pleasure seem to matter for evaluating how well someone's life is going. Nozick's and Sen's arguments therefore point in the same direction: we can live impoverished lives even though we're quite happy about it (or unhappy in spite of affluence). The bottom line is that there is more to well-being than pleasure.

This might not be the end of the story: perhaps the hedonist has ways to avoid these criticisms (Crisp 2008 raises this possibility). We also have to make sense of the fact that contemporary experimental psychologists subscribe to a hedonist theory of well-being. Perhaps we should respond the same way as to the preference-satisfaction theory: pleasure or happiness and well-being are related, albeit not identical. Pleasure is probably a way in which our lives can go well for us, but not the only way, and we can sometimes experience pleasure even though our lives are not going so well for us.

Objective-List Theories

Many things seem to be good for people quite independently of whether they give pleasure or people want them. Health is a good and obvious example. Someone who has never been sick will hardly enjoy being healthy. And yet it is highly plausible to say that that person's health contributes to her well-being. Likewise, chronically ill persons may adapt to their circumstances and, some time after the illness has first set in, are not less happy than healthy persons (Frederick and Loewenstein 1999). It is at least plausible to say that a happy chronically ill person lacks something that a happy healthy person does not lack.

The main idea behind so-called "objective-list theories of well-being" is: there are certain things everyone values, or ought to value, because they are good for him or her. Objective-list theorists then list these things without trying to find a single common element among them.

There are two main sets of issues for an objective-list theory: one having to do with "objective," the other with "list." How are we justified in drawing up such a list? Specifically, what are reasons to believe that philosophers know better what's good for people than those people whose well-being they theorize about? Further, what are the items that should be on the list? How are we justified in including this particular item on the list?

To give a flavor of what a list can look like, consider Martha Nussbaum's (2000: 78-80):

- *Life.* Being able to live to the end of a human life of normal length; not dying prematurely or before one's life is so reduced as to be not worth living.
- *Bodily health.* Being able to have good health, including reproductive health; to be adequately nourished; to have adequate shelter.

Bodily integrity. Being able to move freely from place to plan-; lu\int-ones bodily boundaries treated as sovereign, i.e. being able to be sci uu against assault, including sexual assault, child sexual abuse, anil donu \ tic violence; having opportunities for sexual satisfaction and for cliou i in matters of reproduction.

Senses, imagination and thought. Being able to use the senses, to imagine, think and reason—and to do these things in a "truly human" way, a way informed and cultivated by an adequate education, including, but by no means limited to, literacy and basic mathematical and scientific training. Being able to use imagination and thought in connection with experiencing and producing self-expressive works and events of one's own choice, religious, literary, musical and so forth. Being able to use one's mind in ways protected by guarantees of freedom of expression with respect to both political and artistic speech, and freedom of religious exercise. Being able to search for the ultimate meaning of life in one's own way. Being able to have pleasurable experiences, and to avoid non-necessary pain.

Emotions. Being able to have attachments to things and people outside ourselves; to love those who love and care for us, to grieve at their absence; in general, to love, to grieve, to experience longing, gratitude, and justified anger, or by traumatic events of abuse or neglect. Not having one's emotional development blighted by fear and anxiety. (Supporting this capability means supporting forms of human association that can be shown to be crucial in their development.)

Practical reason. Being able to form a conception of the good and to engage in critical reflection about the planning of one's life. (This entails protection for the liberty of conscience.)

Affiliation-.

- Being able to live with and toward others, to recognize and show concern for other humans, to engage in various forms of social interaction; to be able to imagine the situation of another. (Protecting this capability means protecting institutions that constitute and nourish such forms of affiliation, and also protecting the freedom of assembly and political speech.)
- Having the social bases of self-respect and non-humiliation; being able to be treated as a dignified being whose worth is equal to that of others. This entails, at a minimum, protections against discrimination on the basis of race, sex, sexual orientation, ethnicity, caste, religion, national origin and species. In work, being able to work as a human being, exercising practical reason and entering into meaningful relationships of mutual recognition with other workers.

Other species. Being able to live with concern for and in relation to animals, plants and the world of nature.

Play. Being able to laugh, to play, to enjoy recreational activities.

- *Control over one's environment-.*
  - *Political.* Being able to participate effectively in political choices that govern one's life; having the right of political participation, protections of free speech and association.
  - *Material.* Being able to hold property (both land and movable goods), not just formally but in terms of real opportunity; and having property rights on an equal basis with others; having the right to seek employment on an equal basis with others; having the freedom from unwarranted search and seizure.

The only thing the different items on this list—or any other—have in common is that they all advance a person's well-being, and all in their own way. This is an advantage of objective-list theories: they do not seek to reduce well-being to a single characteristic. Whatever that characteristic may be, chances are that it is possible to construct cases in which someone who lacks that characteristic nevertheless enjoys well-being, and converse cases in which someone has the characteristic but lacks well-being. These counterexamples are much less likely to obtain when the list is longer.

However, a list with two or more items also creates a significant problem. How do we rank the well-being of people who fare differently with respect to the different items on the list? There may be practical problems in measuring people's pleasure but at least conceptually every person's pleasure is commensurable. This is not so with respect to lists: if one person fares better on one criterion and another on a different criterion, there is no way to compare their levels of well-being unless one has a scheme that assigns weights to the different criteria. Using such a scheme, however, undermines the greatest advantage of objective-list theories, namely their relatively open and pluralistic approach to well-being. It is surely more plausible to say that we all value "play" than to say that we all value "play" to the same extent.

A case discussed by Amartya Sen illustrates the issue (Sen 1999b: ch. 4). Extreme poverty is heavily concentrated in two regions of the world: South Asia and sub-Saharan Africa. In terms of income, infant mortality and adult literacy rates the two regions are quite comparable. However, there are sharp differences when one looks at mortality and nourishment. For instance, the median age at death in India is 37 years compared to a shocking 5 years in sub-Saharan Africa; by contrast, 40-60 percent of children in India are undernourished, compared to a "mere" 20-40 percent in sub-Saharan Africa.

Sen uses this case as an illustration of his point that well-being is a multidimensional concept, and that to come to an adequate assessment for policy we do have to look at all morally relevant aspects of the situation. But it is easy to hijack the case to draw attention to a problem of any multidimensional account. For moral evaluation and especially policy analysis we require a basis for ranking two individuals, situations or policies. Suppose as the US government we have a certain amount of money to spend on development aid. Shall we invest it in India or sub-Saharan Africa? An account that regards life, bodily health (including nourishment) and literacy all on a par will not be very useful for making a decision. But trying to construct an index out of the various dimensions will reintroduce problems the pluralist account sought to overcome.

Problems about measuring and weighting the items on the list aside, how do we decide what is on the list in the first place? There are in principle two ways: participatory or philosophically-reflectively, both of which are problematic. To have representatives of the population participate in the decision-making is obviously impractical at the global level. By limiting the decisions to the national or subnational level we would lose the ability to criticize other cultures for failing to respect dimensions of well-being we consider important. Other cultures might, for example, not regard choice in matters of sexual reproduction as valuable. If lists are "objective" only within the confines of a culture, there would be no basis for criticizing that culture.

Proceeding by philosophical reflection faces an obvious legitimacy problem: how can we make plausible to anyone, including members of cultures that subscribe to very different sets of values, that the reflecting philosopher knows more about their well-being than they do themselves? But we must not ignore the fact that the democratic procedure faces a similar problem: why should I accept the values of the majority of my own culture, not to mention every other human being on the planet? Unanimity would in theory be a way out, but the chances of reaching consensus are, given the realities of cultural diversity, quite slim.

The Evidential View of Preferences

It may seem as though we've come to a dead end. There are three families of theories of well-being and all three have serious difficulties. Does that mean that we should stop thinking about well-being and therefore leave many important issues unsettled? There is a way out of muddle, but it requires us to make two changes in the question we are asking. First, rather than asking "What is well-being?" we could ask "What source(s) of information should we consider to evaluate (or measure) people's well-being?" Even if preference satisfaction, happiness and the items on the objective lists that have been drawn up by philosophers are problematic in their function as theories of what well-being is, information about preference satisfaction, happiness and the items on objective lists may well be useful in order to assess people's well-being. Thus, we should stop thinking that preference satisfaction, happiness and items on an objective list *constitute* well-being and rather think of them as *evidence for* well-being (Hausman and McPherson 2009). Second, we should ask about the sources of information about well-being in the context of concrete applications rather than in the abstract. On the one hand, in a concrete application there may be good contextual reasons for preferring one measure over another. On the other, concrete applications might allow us to assess the likelihood of a counterexample actually occurring. A case that speaks against an account as general theory of well-being will not be relevant in the context of a concrete application if it is exceedingly unlikely to occur.

Cost—benefit analysis (CBA) seeks to evaluate socio-economic projects in terms of the net benefit the realization of the project would provide. Net benefit here is understood as the total amount the supporters of a project would be *willing to pay* to realize the project minus the total amount that those who are against the project would require in compensation for agreeing to it. CBA assumes that willingness to pay indicates preference satisfaction. Therefore, the project with the greatest net benefit is regarded as the most efficient at satisfying preferences, and on the preference-satisfaction theory of well-being, the same project is the one that has the greatest capacity to make people better off. CBA is one of the main applications of welfare economics.

Hausman and McPherson 2009 argue that while preference satisfaction is untenable as a theory of well-being, under certain conditions preference satisfaction can provide good evidence for well-being in the context of CBA. The main conditions they discuss are that people are good judges of the consequences of the project for their well-being and that their preferences are self-interested. People are good judges when they are well informed about the consequences of a project and free of biases. People's preferences are self-interested if they prefer states of affairs that promote their well-being. The notion of a self-interested preference thus presupposes a notion of well-being, which would make a preference-satisfaction theory of well-being circular. But since Hausman and McPherson are not after a theory of well-being this is not a problem as long as one can assume that people sometimes know what is good for them, They argue that this is an assumption that can safely be made (Hausman and McPherson 2009: 18).

Do we have reason to believe that the two conditions are sometimes met? Let us consider the question whether people's preferences can be assumed to be self-interested. Hausman and McPherson discuss a case where it is unlikely that people prefer what is good for them: the protection of endangered species. They write:

> The survival of Siberian tigers and whooping cranes bear to some extent on the welfare of individuals because people take pleasure in seeing these magnificent creatures or in merely contemplating their survival from the edge of extinction. But for most people, these pleasures are modest, and there are other non-self-interested reasons why one would prefer that these creatures not become extinct. In the case of endangered species, preferences are a poor measure of benefit.
>
> (Hausman and McPherson 2009: 17)

Thus, people's willingness to pay for policies that protect endangered species is likely to be guided by considerations other than what is good for them, perhaps moral and aesthetic considerations or concern for non-human animals. In such cases, willingness to pay is a bad indicator of well-being. In other cases (perhaps the building of infrastructure such as roads and power supplies) people's willingness to pay may track well-being more accurately.

The other condition was that people do not make mistakes in assessing the consequences of implementing projects. There is considerable work in contemporary psychology that identifies areas where people are biased and likely to make mistakes, and policy-makers can build on this work in order to assess the chances of willingness to pay being an accurate guide to well-being (Hausman and McPherson 2009: 22—3).

There is another partial defense of CBA. In cases where people are likely to be self-interested and good judges of the consequences of a project, willingness to pay seems to be a *better* guide to well-being than alternatives. Self-reported happiness is unlikely to be reliable. There is evidence that such reports are heavily biased by information that is entirely irrelevant. Indeed, how *would* one answer a question such as "Generally speaking, how happy would you be with your life if the bridge were to be built?" Especially when the scales on which happiness is measured are very coarse (for instance, "very happy, pretty happy, or not too happy" in the US General Social Surveys), it is not plausible to assume that the impact of a project on self-reported happiness can reliably be estimated.

Similarly for objective measures. It is unlikely that the potential impact on any of the aspects of an objective-list theory of well-being—mortality and morbidity, mobility and political participation, say—can reliably be estimated. Moreover, here we would also face the weighting/aggregation problem discussed above.

The upshot is, when preference satisfaction is not understood as constitutive of well-being but rather as providing evidence for well-being, there may well be contexts where there are reasons to believe that a CBA based on willingness to pay can provide valuable information. When people's preferences are self-interested and people are good judges of the consequences of a policy, willingness to pay can be a good indicator of well-being. There are a multitude of difficulties concerning the measurement of willingness to pay, and since willingness to pay depends not only on preferences but also on wealth, policies should not be evaluated using "net benefit" as sole criterion. Nevertheless the discussion has shown that preferences are sometimes a defensible source of information for the evaluation of projects in terms of their consequences for well-being.

Conclusions

This chapter has surveyed the three main kinds of account of well-being that are currently being discussed in the philosophical literature: preference-satisfaction, hedonist and objective-list accounts. They all face serious objections. But we have also seen that there is a possible way out. If we understand information about preferences as characterizing *evidence for* well-being rather than what constitutes well-being itself, standard welfare economics can be made more plausible in the context of a limited application.

Welfare economics is therefore not impossible, even if there is no common understanding of its core notion, welfare or well-being. But there is an important implication for the invisible-hand hypothesis with which we began this chapter. Even ignoring the difficulties market imperfections cause (these will be examined in Chapter 13) and the fact that for an outcome to be regarded as socially optimal we may have to look to factors other than well-being alone (this will be examined in Chapter 14), self-interested choices will be transformed into a social good only when people are good judges of what is good for them and make no mistakes in their choices. Assuming that people are always good judges of what is good for them and make no mistake is not an innocuous idealization. When people aren't good judges or make mistakes in their choices or both, and we will see in Chapter 15 that there is at least some evidence that this is not infrequently the case, then the invisible-hand hypothesis is false and self-interested choices do not automatically lead to social benefit.

Study Questions

1. Is welfare economics necessarily a value-laden subject?
2. What theory of well-being do you find most convincing? Defend your answer.
3. The section on "Well-Being and the Satisfaction of Preferences" in this chapter presented a number of fixes to the actual preference-satisfaction theory of well-being. Can you think of further amendments to the theory that overcome the remaining problems?
4. What are the consequences of the criticisms of the preference-satisfaction view of well-being discussed in the section on "Well-Being" in this chapter for welfare economics?
5. Could one also construct evidential accounts of well-being that take information about happiness or items on objective lists such as health and education as evidence for well-being? What would be the differences between such accounts and that presented in the section on "The Evidential View of Preferences" in this chapter?

13 Markets and Morals

Overview

Economists often justify their advocacy of free markets by the invisible-hand hypothesis. Recall from Chapter 12 that the hypothesis holds that if people pursue their self-interest, then free markets will lead to a socially desirable outcome. It implies that organizing goods exchanges by free markets is (not necessarily the only but) one effective strategy to reach a socially desirable outcome.

But what are "free markets"? Pre-analytically, one might understand the term as referring to markets involving no or a minimum of government intervention. Whatever the virtues of that understanding, it is not what is required for the invisible-hand hypothesis. The first fundamental theorem of welfare economics (the analytical part of the hypothesis) assumes, among other things, that producers and consumers behave competitively and are perfectly informed, and that markets are complete. Producers and consumers behave competitively when they are price takers; they are perfectly informed when they possess all information relevant to their transactions; and markets are complete when everything people value has a price at which it can be exchanged without transaction costs. In many existing markets producers or consumers have considerable market power, information is not perfect and markets for many goods are non-existent. A better term for what is required for the invisible-hand hypothesis would be an "ideal market system." An ideal market system is, quite obviously, not the same as "free markets," pre-analytically understood.

This chapter looks at some of the ethical implications of mixing up free markets and the ideal market system. It will ask two main questions. First, are the moral implications of the invisible-hand hypothesis still valid when markets operate "freely"—that is, with no intervention by the government or other regulatory agency—but the assumptions of the ideal market system are false? Second, are certain interventions that make actual markets more like an ideal market system morally justified?

The two questions are closely related. If a market imperfection that leads to a morally undesirable outcome occurs, then interventions that eliminate the market imperfection seem justified (at least as long as the regulated market does not produce a morally inferior outcome). But as we will see, it is guaranteed neither that the moral implications of market failure are easily evaluated nor that interventions with a view to making actual markets more ideal are always desirable. Markets, then, are moral minefields.

Market Failure

Markets fail for numerous reasons. This is hard to deny. The interesting issues are how to respond to what kinds of market failure, and on what moral grounds. In this section I will go through the most common kinds of market failure—market power, informational asymmetries and externalities—and very briefly discuss some of the responses that have been given. This will be a boring section to readers with an economics background, but it is important to know the kinds of market failure that may obtain in order to see what is at stake in the discussion of the cases concerning moral challenges to the market that will follow. So please bear with me (or skip ahead).

Monopoly and Market Power

Western philosophy is often said to begin with Thales of Miletus, who thought that everything was made of water. Aristotle said so, and so did Bertrand Russell (Aristotle, *Metaphysics A:* 983b18; Russell 1967). The beginning of Western philosophy has a date, too: 585 BC, the year in which a solar eclipse occurred that Thales had predicted. Thales was, however, known for more than his mythology-free explanations of natural phenomena. According to one anecdote, Thales became tired of people poking fun at him for his poverty, which was supposedly due to the practical uselessness of philosophy. To demonstrate that philosophy wasn't necessarily an unprofitable enterprise, one winter he bought, at small value, all the olive presses in Miletus after predicting a particularly good harvest on the basis of his knowledge of astronomy. When harvest came presses were in enormous demand, and Thales could charge any price he wanted. Aristotle concluded: "He is supposed to have given a striking proof of his wisdom, but, as I was saying, his device for getting wealth is of universal application, and is nothing but the creation of a monopoly. It is an art often practiced by cities when they are in want of money; they make a monopoly of provisions" (*Politics*, book I, part XI). At the beginning of Western philosophy, then, stands an exercise of market power.

The invisible-hand hypothesis assumes that both producers and consumers behave competitively. There are a variety of reasons why they might not do so. A so-called "natural monopoly" arises when a producer faces high fixed costs and increasing returns to scale in the relevant range. If that is the case the average cost of production declines as the quantity produced increases, and it is always cheaper for one large instead of many small companies to supply the quantity demanded. An example that is often given is utilities. The production of electricity and the supply of water require enormous initial investments in infrastructure but the production of an additional unit of the good is practically negligible. In addition to natural monopolies there are government-granted monopolies where the lack of competition does not stem from production technologies but government enforcement.

Economies of scale and government grants are two kinds of barriers to entry that enable companies already in the market to exert market power. There are numerous others. A situation analogous to that of the natural monopoly can arise when the value of a good to a user increases with the number of other users; that is, when there are network effects. Think of the position Microsoft occupies in the market for PC operating systems. When there are network effects, the first company in the market (or the company whose product is adopted as standard) can have an enormous advantage quite independently of the quality of the good. Other barriers to entry include the control of natural resources (for instance, OPEC's control over oil in the 1970s) and the technological superiority of a large firm that is better able to acquire, integrate and use the best possible technology in producing its goods.

Though everyone who has received some economics tuition knows how to calculate the deadweight loss created by monopoly price-setting, it is not guaranteed that monopolies or other forms of market power are welfare-decreasing or morally undesirable in other ways. The standard model compares consumer and producer surpluses under monopoly pricing versus competitive pricing *in the same good*. But one important way to create temporary monopolies is by innovation. An innovating firm creates a new product and is able to charge higher prices until imitators have come up with substitutes that are good enough. The monopoly profit an innovator makes in the period he can charge a higher price is an important incentive to innovate in the first place. Without such monopolies there might be less innovation. Now, while it is not the case that consumers benefit from *all* innovation

(Reiss 2008a: ch. 3), it does not require an enormous stretch of the imagination to see that consumers do, by and large, profit from highly innovative industries. This, in turn, means that whether the existence of market power is morally desirable or undesirable cannot be answered in abstraction from the details of the concrete markets where the market power is exercised.

Informational Asymmetries

Another reason why producers and consumers do not always behave competitively is that they are not perfectly informed about aspects of the traded good, and, in particular, that relevant information is asymmetrically distributed between two traders. The seminal paper to introduce considerations about information distribution into mainstream economics was George Akerlof's "Market for 'Lemons'" (Akerlof 1970). This paper showed how asymmetric information can lead to a complete market breakdown.

Akerlof's reasoning was essentially this. When traders are asymmetrically informed about the quality of a good such as a second-hand car, an individual's labor or a person's health, and sellers know more than buyers, those who know that their good is of low quality (i.e., those who own a "lemon" or whose labor or health is of bad quality) will be incentivized to sell their good, while those in possession of a high-quality good will have an incentive to keep theirs. This is because the market will offer at best an average price across all qualities, as buyers cannot observe the quality. But rational buyers will predict this behavior on the sellers' part and offer a price below the average (because they know that the chances of getting a high-quality good are very low). This only strengthens the incentives to keep high-quality goods out of the market until only the lowest-quality goods remain. His lesson is thus: Markets in which the quality of goods matters but is not observable by buyers are thin, and prices and qualities low.

One mechanism to overcome this type of market failure is the signaling of the good's quality by the seller. For instance, firms may invest in brand names consumers can use to determine quality. The consumer knows that particular brands have supplied high-quality goods in the past and that the producer has an incentive to maintain the quality in order not to destroy the value of the brand name. Given the initial investment in the brand name is very costly and the cost of producing an additional unit of the good relatively low, information asymmetries provide another source of market power from barriers to entry.

A special kind of information asymmetry leads to principal-agent problems. These can arise in situations in which one individual, called the principal, hires another individual, called the agent, in order to perform a specific task. The principal cannot observe the effort the agent puts into the fulfilling of the task, and the result is in part due to chance. Examples are employer-employee contracts, contracts between insurers and insured persons, shareholder-manager or doctor-patient relations.

Take the latter as an example. Patients normally do not know, or not as well as their doctors, about the relative efficiency and effectiveness of treatment options. Moreover, there is always a large element of chance involved in any treatment, so an adverse treatment result cannot easily be blamed on poor doctor performance. A purely self-interested doctor will exploit this situation and recommend treatments that are good for him and not necessarily in the patient's best interest (especially when the patient is insured and therefore bears the cost only indirectly). Rational patients will, in turn, predict this behavior and seek a suboptimally low level of doctors' services (or, in a system where insurance is mandatory, costs will be inefficiently high).

Two further concepts may be of use here: *adverse selection* and *moral hazard*. Akerlof's lemons model, when applied to the insurance market, is a model of adverse selection. The "quality" at stake here is not the quality of a used car but rather an insured person's health (which may be expressed in probabilities of contracting all kinds of diseases). Insurers will not as a matter of principle be able to observe the health status of those seeking insurance. When patients know their health status better (because they know whether they are smokers and drinkers and whether they engage in dangerous hobbies such as parachuting and eating *foie gras)*, the situation is analogous to Akerlof's lemons market. In a free market, only the lowest-quality risks will be insured, which most certainly is not a good thing.

Another aspect of the contract between insurance provider and buyer is the fact that the buyer can influence the probability of occurrence of the insured event. Will I lock my bike if it is fully insured for theft? Will I accept a generic instead of a branded drug if I'm fully insured for treatments? Will I turn off the gas if my flat is fully insured for fire? Will I stop smoking if I am fully insured for cancer treatments? No? Then I'm subject to moral hazard. Moral hazard refers to the incentives insurance and other similar contracts provide for the buyer not to take every possible precaution in avoiding the payment of insurance claims. Moral hazard, too, causes inefficiently low levels of insurance.

Public Goods and Externalities

Many goods in the economy are such that when one consumer has it or consumes it, the ability of others to also enjoy it are diminished or nil. I cannot both eat and share a cherry. To the extent that I have a cherry, you can't have it. But not all goods are that way. I'm currently listening to the Dave Matthews Band's *Busted Stuff*, and whether you do so too does not affect me in the least. Goods like cherries economists call "rival in consumption" and goods like listening to music, "non-rival."

There is a second dimension. Some goods are such that their producers can make sure that those who benefit from the production of the good actually pay for it. Short of illegal activities, producers of cherries or CDs can make their customers pay. But this is not the case for the producer of clean air, national defense or, at least in the old days, radio and television. Once the air is clean, everyone will benefit from it independently of whether they've paid for it. Ihe same is true for national defense and was true for public broadcasting before the advent of encryption technologies. Economists call cherries and CDs goods that are "excludable" and clean air, national defense and broadcasting "non-excludable."

Public goods are goods that are non-rival and non-excludable. Clean air, national defense and radio broadcasts are examples of goods that have both characteristics. It is important to note that it is a good's physical characteristics and technological possibilities that make it public or private, not, or not so much, the institutional setting in which it is traded. Before the encryption technologies were available, radio and television broadcasting was a public good. With the new technology users can be excluded. These public goods were thereby transformed into club (non-rival, excludable) goods. This is independent of whether it was (prior to encryption) legal for the public to watch television or listen to the radio without paying a fee. Music (and other media, such as films, books, magazines, etc.) experienced a transformation in the other direction. Before digital computers made high-quality sharing extremely cheap, these goods were so-called "club goods" (non-rival and excludable) because a consumer had to buy a record in order to enjoy the music. The digital revolution turned these into public goods, as it is very hard for producers to control who listens (or reads, watches ...). Once more, whether or not the producer is protected by a copyright does not affect these characterizations.

Public goods are underproduced in free markets because individuals have incentives to free ride. The decision to invest in a public good can be modeled as an «-person Prisoner's Dilemma, and in equilibrium contributions are zero for all individuals, which means that the public good does not get produced (see Chapter 10). People's actual behavior doesn't quite conform to the game-theoretic prediction, but it is clear that to the extent that people free ride, public goods are provided at inefficiently low levels.

Various solutions have been proposed, including assurance contracts in which participants make a binding pledge to contribute to building a public good, contingent on a quorum of a predetermined size being reached, government provision and government subsidies, all of which require a great deal of coordination among the contracting partners.

An *externality* is a cost or benefit of a transaction on individuals who are not a party to the transaction. A producer sells his goods to customers at marginal costs. But his production technology involves pollution. He, the consumers and others will suffer from the pollution but this "cost" is not reflected in the price the producer charges. Externalities can be positive or negative. If I play the piano during lunch hour, and my neighbors overhear it, this is a positive externality If I were to play Lady Gaga on the radio, this would be a negative externality. Examples for positive externalities include education (which benefits the individual but also society), beekeeping (through pollination), vaccination, painting one's house in an attractive color. Examples for negative externalities include pollution and climate change, the systemic risk some large banks incur, the use of antibiotics if it contributes to antibiotic resistance, drug abuse.

Public goods and positive externalities are in fact the opposite sides of the same coin. If a private radio station were to be set up in a neighborhood, paid for by the neighbors, others could profit from it free of charge. The transaction between radio station and neighbors thus has positive externalities. Conversely, pollution can be regarded as a negative public good or "public bad." If it is produced, it affects people if they want it to or not. And by affecting one person, another person's ability to be affected is not diminished. Negative externalities are therefore overproduced, positive externalities underproduced.

The solutions are also analogous. Public solutions include government taxes (in this case called "Pigouvian taxes," after the British economist Arthur Cecil Pigou) and subsidies aimed to bring production up or down to efficient levels. Private solutions include neighborhood associations where neighbors regulate precisely what kinds of externality-laden actions (playing the piano, painting one's house, mowing one's lawn) are permissible and under what conditions.

Transaction Costs and the Coase Theorem

At first sight, one would think that the allocation of property rights should play an important role in markets with externalities. If, say, the inhabitants of a region have the right to clean air or water or soil, companies intending to use dirty production technologies will either (inefficiently) have to refrain from using these technologies or agree with their "victims" on a compensation scheme that enables efficient trades in externalities. Therefore, under well-defined property rights, it is possible that private parties find efficient solutions to externalities problems. The economist Ronald Coase has shown that if there are well-defined property rights and trade in an externality is possible and there are no transaction costs, bargaining will lead to an efficient outcome *regardless of the initial allocation of property rights*. Discussing the theorem named after Coase provides an opportunity to demonstrate how the various market imperfections introduced so far—such as public goods, externalities and information asymmetries and property rights—are interrelated.

Explaining the Theorem

The first thing Coase claims is that externalities are a joint product of two parties (Coase 1960). Neither pollution nor beautification would constitute an externality unless there was, next to the producer, another party on the receiving end. From an efficiency point of view, it is not guaranteed that interventions (such as Pigouvian taxes) affecting only the producer are always best. If my neighbors are disturbed by my piano-playing after all, I could stop altogether or not play when they're in or soundproof my flat, but they could also soundproof theirs or move out. From an efficiency point of view, it does not matter who changes behavior but what the cheapest solution is, and that might be on the side of the "victim" of the externality.

Suppose my piano-playing is so bad that my neighbors, after having to listen to me for three months, find it so nerve-racking that they could go on living in their apartment only if they undergo intense counseling, at a monthly cost of €500. They were planning to live in their apartment for another 10 years, so the total cost would come to €60,000. (These costs are meant to be all-encompassing; that is, my neighbors are assumed to be indifferent between living in their flat without noise and continuing to endure the noise with €60,000 in hand for medical and other expenses.) Moving to a new place would cost only €40,000. Soundproofing either flat would cost €80,000, and let us suppose that my stopping playing the piano or moving out would cost me €100,000. The Coase theorem now says that the allocation of property rights is ignorable, provided there are no transaction costs. To see this, first assume that I have the right to make any noise I want (because, say, I own the apartment building, or because I've lived there for longer, or because the culture we live in values piano-playing more highly than peace and quiet). In this case, my neighbors would make a simple calculation, see that their moving out is the lowest-cost solution to them and move out. But (nearly) the same would happen if my neighbors had a right to peace and quiet. Assuming as we did that they'd be indifferent between staying in the flat, now quiet, and moving out plus cash payment of€40,000,1 can give my neighbors that money plus a little extra for their troubles, and they'd happily accept and move out. Apart from an extra €40,000 in my neighbor's pockets (and corresponding loss in mine), the outcome is the same.

Now suppose that the "polluter" is not facing one "victim" but many. The "polluter" might be a company using a dirty industry and the "victims" the entire population of the region affected by by-products of the production process. Given the affected population is large, it is likely that the most efficient solution requires the firm to install emission controls. But if the firm has the right to pollute, the individuals living in the affected area face a collective-action problem analogous to contributing to a public good. Everyone has an incentive to free ride, and it is unlikely that the public good—clean air in this case—will be produced. The converse is true when people in the region have the right to live pollution-free. The firm could offer compensation, but since each individual has a veto right, everyone has an incentive to use his or her bargaining power to extract more money and negotiations will break down.

Coase regards these adverse incentive structures as creating transaction costs. In the absence of transaction costs, efficient solutions can be found, and the allocation of property rights does not matter. With transaction costs, the free market is unlikely to supply efficient solutions, and the allocation of property rights matters a great deal. In the last example, the firm using a dirty production process will produce an inefficiently high amount of pollution unless the affected individuals are able to solve the collective-action problem *if it has the right to pollute-,* if people have the right to clean air, an inefficiently low amount of pollution will be produced.

The discussion of the Coase theorem nicely illustrates how different kinds of market imperfections interrelate. More importantly, it makes plain that it is not normally possible to ignore moral considerations when one thinks about how best to organize or regulate production processes. In the next subsection I will look at some of the relevant considerations.

The *Moral Limits of Coase's Theorem*

Coase's essay is titled "The Problem of Social Cost." Let us focus on the idealized case in which there are no transaction costs first. The "social costs" Coase considers are measured exclusively in terms of efficiency. As we saw in the previous chapter, an allocation is Pareto-efficient if and only if there is no alternative allocation that makes at least one individual better off without making at least one individual worse off. "Better off" and "worse off" are understood in terms of (actual) preference satisfaction. An individual is thus regarded to be better off in social state S' than in the status quo S if and only if that individual prefers S' to S (and vice versa for "worse off").

Coase's reasoning thus depends on measuring social costs and benefits in terms of their consequences:

- on the *welfare*
- of *individuals*
- as measured by (actual) *preference satisfaction*
- irrespective of *distributional considerations.*

All these assumptions are problematic. That more matters in the moral assessments of economic transactions than just the consequences of the transaction on the welfare of the affected individuals can easily be seen if we consider exchanges that are, albeit welfare-enhancing, extremely unfair. Suppose for instance that the dirty producer from the last subsection is a multinational setting up its plant in an area characterized by abject poverty. Even if the inhabitants living in the area have the right to clean air, chances are that they will agree to a compensation scheme that, while making them better off, is exploitative. The multinational has vastly more bargaining power. If the deal falls through, it will simply move to another region. The area's inhabitants do not have this option. Their lives might well improve with new business in the area, but nevertheless the exchange can be considered exploitative (cf. Hausman and McPherson 2006: 20). This might not be a compelling reason against exchanges of this kind but it does cast doubt on the idea that evaluating economic transactions should be done in terms of consequences on welfare alone.

Of course, the point about the fairness of exchanges goes both ways. In the piano-playing example, a mischievous neighbor who has the right to enjoy his flat in peace and quiet might exploit my situation if I really need to practice the piano and, because of the architecture of our apartments (say), soundproofing mine costs four times as much as soundproofing hers. If there are no other alternatives, she can get me to pay nearly four times the cost of soundproofing her apartment, which would still result in a Pareto-improving exchange.

The outcome of exchanges, then, will crucially depend on the relative bargaining power of the parties to the exchange and that will depend on their outside options. By and large, people or institutions with more wealth and political power have more outside options. But it seems unfair that their preferences should matter much more in negotiations concerning compensation for externalities. Adam Smith, in *The Wealth of Nations*, describes an analogous situation in a different context as follows:

> It is not, however, difficult to foresee which of the two parties must, upon all ordinary occasions, have the advantage in the dispute, and force the other into a compliance with their terms. The masters, being fewer in number, can combine much more easily; and the law, besides, authorises, or at least does not prohibit their combinations, while it prohibits those of the workmen. We have no acts of parliament against combining to lower the price of work; but many against combining to raise it. In all such disputes the masters can hold out much longer. A landlord, a farmer, a master manufacturer, a merchant, though they did not employ a single workman, could generally live a year or two upon the stocks which they have already acquired. Many workmen could not subsist a week, few could subsist a month, and scarce any a year without employment. In the long run the workman may be as necessary to his master as his master is to him; but the necessity is not so immediate.
>
> (Smith 1904 [1776]: book I, ch. 8)

Second, it is not uncontroversial that only the consequences for individual human beings should matter. Perhaps we should be concerned also with the environment and animal welfare. Perhaps pollution is an ill that is to be avoided at a greater cost than economic efficiency.

Third, we saw in the previous chapter that the preference-satisfaction theory of well-being is mistaken. In the context of Coase's theorem, the problems of the theory come to the forefront. People will often engage in exchanges even though they are bad for them. Incomplete information is one important reason, and asymmetrically distributed information might be an additional reason for considering certain kinds of exchanges as morally problematic.

Who could quantify precisely the consequences of noise or other kinds of pollution for his or her well-being? Even if one does, it is important that this information is common knowledge. Otherwise the parties have incentives to overstate costs or harms. Asymmetrically distributed information can therefore lead to asymmetric bargaining power in much the same way as outside options. Just consider a situation in which a "polluter" knows both the cost of reducing emissions as well as the likely harm pollution incurs whereas the "victim" has only a very imprecise estimation of the harm (see Hahnel and Sheeran 2009 for a detailed discussion of the informational requirements behind the Coase theorem).

The last issue is that Coase's bargaining solutions ignore distributional issues. If compensations for externalities exacerbate existing inequalities, as is likely to be the case when the negotiating parties have different bargaining power, exchanges may be considered to be morally undesirable even if they are welfare-enhancing. This is closely related to the first point about fairness but not the same. Often we may consider an exchange to be unfair because it arises from harsh inequalities (as in the example above) or because it creates them. But we can imagine cases where an exchange is unfair not because it creates distributional inequalities but because one of the parties has been tricked or misled by the other party. And we can imagine cases where an exchange is fair in many ways except that it creates inequality.

We will examine distributional issues in greater detail in the next chapter. For now, let us move on to a fascinating case where it is likely that current government regulation moves actual markets further away from the ideal system of the invisible-hand hypothesis rather than closer to it.

Intellectual Property Rights

Intellectual property rights are, as their name suggests, kinds of property rights. Property rights are often considered to be the key to economic activity and prosperity, especially by economists with libertarian leanings (e.g., Hayek 1960; M. Friedman 1962; D. Friedman 1989 [1973]). In philosophical discussions, property rights are usually understood as relating to land and other natural resources, and their essence as the exclusion of others from the use of the resource (e.g., Wolff 2006: ch. 5). In the ideal-typical case, the holder of a property right has a claim to a plot of land, say, and the main content of the claim is his ability to stop others from trespassing by building a fence around it. But things aren't quite so simple, as the following passage from Friedman's *Capitalism and Freedom* suggests:

> A still more basic economic area in which the answer is both difficult and important is the definition of property rights. The notion of property, as it has developed over centuries and as it is embodied in our legal codes, has become so much a part of us that we tend to take it for granted, and fail to recognize the extent to which just what constitutes

> property and what rights the ownership of property confers are complex social creations rather than self-evident propositions. Does my having title to land, for example, and my freedom to use my property as I wish, permit me to deny to someone else the right to fly over my land in his airplane? Or does his right to use his airplane take precedence? Or does this depend on how high he flies? Or how much noise he makes? Does voluntary exchange require that he pay me for the privilege of flying over my land? Or that I must pay him to refrain from flying over it? The mere mention of royalties, copyrights, patents; shares of stock in corporations; riparian rights, and the like, may perhaps emphasize the role of generally accepted social rules in the very definition of property. It may suggest also that, in many cases, the existence of a well specified and generally accepted definition of property is far more important than just what the definition is.
>
> (M. Friedman 1962: 26-7)

Property, then, is usually thought of as pertaining to physical things. Not all economic goods are physical things, however. We encountered earlier in the chapter a selection of non-physical goods: music, radio and TV broadcasting, education and many kinds of services. Some of these goods have the property of non-rivalry. Can and should we have property rights in non-rivalrous goods? Defenders of *intellectual* property rights think so.

Intellectual property rights come in two main forms: patents and copyright. Patents provide the right to exclude others from making, using, selling and importing an invention for the term of the patent in exchange for making the invention public. A copyright gives the holder the exclusive "right to copy," which also includes the right to be credited for the work, to determine who may adapt the work to other forms, who may perform the work, who may financially benefit from it and so on. In their modern form, both patents and copyright date back to at least the Renaissance. Inventors were granted monopolies in Venice and Florence in the fifteenth century. Copyright was introduced after the invention of the printing press, which took place in the Holy Roman Empire in around 1440.

The "property" nature of patents and copyright is evident. Like ordinary property, intellectual property gives the holder a right to exclude others from using his or her property. Like the first American settlers claiming a plot of land and building a fence around it, the inventor of a new process or contraption or song or story claims the process, contraption, song or story to be his or hers and stops others from using it without purchasing the right to do so. Unlike ordinary property, intellectual property does not pertain to a physical thing, however, but to an idea.

Ideas are not only non-rivalrous but also non-excludable. That is, they are public goods. If I invent a contraption that helps me transfer ground coffee from its vacuum pack to the coffee tin without much spillage and you hear about it, your rebuilding my gadget does not in any way diminish the usefulness of my gadget for me. Moreover, I cannot protect my idea by physical means (such as building a fence around it). In a free market, once an idea is out, it's out.

As we saw above, in a free market public goods are undersupplied. Who on earth would bother racking his brains to come up with a contraption for pouring coffee into a tin if he could just sit there and wait until his neighbor invented it? Standard wisdom is therefore that just as people have to be ¿/«couraged from polluting because of its negative externalities, they have to be ¿•«couraged to create ideas because of the positive externalities they come along with.

But there is a downside to providing state-sponsored incentives to generate ideas: intellectual property gives the creator of an idea monopoly rights over the use of the idea for a period of time, and market power is not always a good thing. To see when it is bad, we first have to understand an important difference between ordinary property rights and intellectual property rights. Ordinary property rights, too, give the holder the exclusive right over her property. But in the case of physical things, the right is over a *token:* this apple, that plot of land and so on. In the case of intellectual property, the claim is over a *type:* the design of a contraption (rather than its physical instantiation in a machine, say), the words of a novel (rather than its physical instantiation in a book), the composition of a music piece (rather than its physical instantiation in a CD or computer code). If I own a plot of land and am entitled to its fruit, I can stop you from eating my apples but I cannot prevent you from copying me by claiming your own land, growing your own apples and even selling them as my competitor. If I own the copyright to this book (as I do) I can well prevent you from making your own copies and especially from selling them. Ordinary property rights therefore tend to encourage competitive behavior (presumably, if I didn't own my apples, you'd just take them rather than growing your own), while intellectual property rights tend to prevent competition because they create monopolies over types of things.

So there seems to be a trade-off: on the one hand, we need incentives to encourage the creation of ideas; but on the other, we do not want to encourage anti-competitive behavior on the part of monopolists in ideas. This trade-off is well appreciated in the economic literature:

> The basic problem is that the creation of a new idea or design … is costly … It would be efficient, ex post, to make the existing discoveries freely available to all producers, but this practice fails to provide the ex ante incentives for further inventions. A tradeoff arises … between restrictions on the use of existing ideas and the rewards to inventive activity.
>
> (Barro and Sala-i-Martin 1999: 290; quoted from Boldrin and Levine 2008: 158)

Theoretically, we seem to be at an impasse, then. How else might we justify the existence and protection of intellectual property rights? The literature provides three answers: an argument from natural rights, an argument from personality and a utilitarian argument (De George 2009).

The argument from natural rights is an application of Locke's defense of (ordinary) property rights, which will be discussed in the next chapter. In essence, Locke argues that people can acquire property rights over land and other natural resources, subject to certain provisos, because they own themselves, thus have the right to preserve themselves, and they own the fruits of their labor. Further, by mixing their labor with a (previously unowned) physical thing they acquire ownership over that thing. We will see in the next chapter how successful these arguments are in defense of ordinary property rights. Here we should ask whether the analogous arguments work for intellectual property rights.

Land and its fruit on the one hand and ideas on the other are quite different kettles of fish. Unlike food, clothing and shelter, ideas, especially of the kind that fall under intellectual property protection, are not needed for survival. To be able to appropriate something if it is necessary to ensure one's survival seems fair enough. But an invention will help me in my struggle for survival whether or not someone copies it from me. If I have leisure enough to write a novel, why should I be empowered to stop others from reading it?

Further, land and natural resources can be regarded as "commons," owned by everyone prior to acquisition. Ideas, by contrast, do not exist prior to their invention. By mixing one's physical labor with a physical resource, one enhances the value of the resource. So perhaps one should benefit from increasing its value. If others were to take the fruit of one's labor, one would lose that benefit. In the case of creating ideas, however, one can benefit whether or not another also benefits. Stopping others from also benefiting seems much less justifiable in case of a non-rivalrous good.

The argument from personality builds on the Hegelian idea that property is the outward symbol of one's personality. Thus, one owns one's attainments and talents as something internal to one, but expresses them in something embodied, external. But just as one cannot give up one's freedom, one cannot give up one's right to externally express one's personality in, say, a book or record. So one maintains ownership of the idea.

No matter how successful this argument is where it applies (apparently this Hegel-inspired view is very prominent among legal scholars in continental Europe; see De George 2009: 417-18), it underwrites at best a very limited form of copyright such as the right to have one's name listed as author when the work is published and no one else's, the right to protection from defamation or maltreatment of the work and so on. The Hegelian argument does not seem to provide a reason to prevent others from copying one's idea.

The final argument in favor of intellectual property is a utilitarian one, and the most important of the three. The utilitarian has to address the question: What would the world be like if there was no intellectual property? Defenders of intellectual property might say, "Just look to the Soviet Union and other communist regimes and compare their standard of living with ours!" But of course, there are many differences between these and capitalist countries, and so the difference in standard of living cannot be attributed to differences in intellectual property regimes. Historically, it seems that in the nineteenth century the US patent system was regarded as successful in stimulating innovation and technological progress and therefore adopted by many other nations: "U.S. institutions performed well in stimulating inventive activity. Not only did they enhance the material incentives to inventors of even humble devices with grants of monopoly privileges for limited duration, but they also encouraged the development of a market for technology and the diffusion of technological knowledge" (Khan and Sokoloff 2001: 234-5). But once more, it is clear that there are other differences between the USA and other nations than rate of innovation and patent system.

There is in fact quite substantial evidence that intellectual property stifles rather than encourages innovation. Some theoretical considerations point in that direction. On the one hand, by patenting certain processes or contrivances, the development of others is hindered. New ideas always build on old ideas. By preventing the creator of a new idea using an old one, new products can often not be developed. To give just one example, James Watt's first steam engines were less efficient than they could have been because he was prohibited from using a method to efficiently transform reciprocating motion into rotary motion he had developed by a patent held by the inventor James Pickard (Boldrin and Levine 2008: 2). Such "innovation chains" are common to all areas of technological research and development. Especially in biomedical research, scientists are often hindered in their efforts to develop new medical therapies because competing researcher teams or pharmaceutical companies hold important patents on compounds, genes, microorganisms and the like.

On the other hand, patents create monopolies and thereby encourage rent-seeking behavior. James Watt is again a case in point. During the term of the patent of Watt's steam engine, few steam engines were built. Watt really started to manufacture steam engines only after his patents expired. Before then, he devoted his efforts primarily to extracting hefty monopolistic royalties through licensing as well as legal action targeted at fending off competitors and protecting his monopoly (Boldrin and Levine 2008: 2).

Moreover, it does not seem to be true that there would not be innovation without patents, copyright and the monopolies created by them. In Watt's case, the development of new steam engines and wide adoption happened only after his patent expired. There are many examples for creative activity that makes do without IP protection: open source software, the distribution of news on the internet, the creation of music and literature before copyright was invented (i.e., during most of its existence), financial innovation prior to 1998 (for these and more examples, see Boldrin and Levine 2008: chs 2, 3).

In case of the market for ideas (inventions, books, music, etc.) the regulation of one type of market failure (the undersupply of a public good) creates another type of market failure, namely the monopoly power of the creator of the good. We seefn to be stuck between a rock and a hard place. Personally I find the evidence and arguments provided by Michele Boldrin, David Levine and others to the effect that intellectual property rights are harmful persuasive. But whatever the result of the utilitarian calculation of their harms and benefits, it is clear that there is a large and growing segment of the economy for which a straightforward application of the invisible-hand hypothesis is simply impossible.

Commodification: What Money Can't Buy

Another way of trying to make actual markets resemble more closely the ideal market system is by introducing markets where formerly there were none; that is, by making the market system more complete. Allegedly, there is a tendency for market economies to extend the reach of the market to more and more spheres of life. Indeed, today you can pay for dating services, to skip ahead of the queue, to sit in an acceptable seat on a plane, to have your book displayed prominently in a bookshop (such as in the window), to send your kid to a school in which she stands a lower risk of being victim to a fellow pupil running amok; you can be paid for donating your blood, kidney, egg or sperm or offering "reproductive services," for your good grades or losing weight, for your right to immigrate to the USA, for your right to pollute.

The invisible-hand hypothesis assumes that there are markets in everything. But is that a good thing? Should we, perhaps, forgo efficiency for the sake of some other good? Some philosophers have argued that there are things that *should* not be for sale. At least three arguments can be identified in the literature. A premiss of the first argument, the argument from fairness, we have already encountered above: not all exchanges that are voluntary are also fair. If the market exchange of a certain kind of good necessarily, or usually, involves unfairness for one of the parties involved (especially when it's always the same party, or if the disadvantaged parties are always members of the same segment of society), then there might be a good reason to proscribe market exchange in that good. The second argument, the argument from degradation, has to do with the kind of valuation specific forms of exchange allow. It says that market exchange may corrupt the exchanged good if markets are not the appropriate place to trade that good. The third argument is a utilitarian one. It says that substituting markets for other forms of exchange may sometimes be welfare-diminishing. Let's consider the three arguments in turn.

The Argument from Fairness

To understand this argument, suppose that in some faraway town there is only one employer, Monohire. Monohire employs everyone in the faraway town who seeks work, but only for in-kind payment in the form of a bed and two meals a day. The firm allows exchanging one of the meals for a small cash payment. As it happens, Monohire controls the sole railway from the faraway town. People are free to leave whenever they want, but they have to purchase tickets from Monohire which cost the equivalent of a year's worth of second daily meals.

Those who work for Monohire are assumed to do so voluntarily. The exchanges are most likely to be welfare-increasing—without Monohire, its workers would starve. But the exchanges are certainly exploitative on the part of Monohire. Monohire is not only a monopsonist concerning labor, it is also a monopolist concerning exit options. This allows the firm to pay very low wages and charge very high prices for the company railway. These circumstances, in turn, make alternative options for the inhabitants of the faraway town very unattractive. But exchanges are fair only to the extent that not entering the exchange is a feasible, realistic option.

What this example highlights is that considerations other than "effects on the well-being of the parties involved" matter for the moral evaluation of market transactions. Many actual exchanges may be voluntary but unfair in this sense. A single mum selling her secretarial services to a multinational at a wage far below the market rate may be one case in point, and a teenage prostitute selling sexual labor to fashion designers in support of his drug addiction another. If outside options are rare, voluntary exchanges may well be unfair.

It is important to see that what matters is not only whether the market participant has an actual range of outside options but also what he or she knows. Exploitative exchanges can occur even though the inferior party actually has attractive outside options but does not know about it, and the dominant party capitalizes on this fact.

Now add to this the empirical claim that certain markets almost always involve unfair exchanges understood in this way. Then we would have a good argument for not allowing the sale of goods or services in that market. Some argue that prostitution is such a market: prostitution is rarely if ever "fair" because those who sell their bodies for money are forced to do so "by poverty, drug addiction, or other unfortunate life circumstances" (Sandel 1998: 95).

Two comments on the argument from fairness. First, whether a market, be it that for sexual services or any other, is fair depends in part on empirical facts that cannot be settled by *a priori* argument alone: What outside options do participants have? Are these outside options attractive enough to constitute genuine alternatives? Would participants continue to engage in exchange of this kind if they were fully informed?

Second, it is not at all clear that prohibiting markets in these areas is the best strategy to solve the ethical problems associated with them. Obvious alternatives include improving people's informedness and enhancing their outside options. If coercion is the problem, coercion can be tackled by means other than prohibiting markets in certain goods. It can be tackled by stopping the "forced" of "forced exchange" rather than the "exchange."

The Argument from Degradation

The second argument is more powerful if it is successful. Perhaps the problem is not that prostitutes tend to be forced into selling their bodies but rather that the activity is intrinsically degrading. If the activity is intrinsically degrading, then the improvement of participants' living conditions cannot help. Then market exchange is bad *per se*. In essence, the argument says that exchanging certain goods on a market cannot provide the kind of valuation adequate to this good, and engaging in market exchanges of the good undermines its proper valuation. A forceful proponent of this argument is Elizabeth Anderson (e.g., E. Anderson 1993), so here I shall examine a number of examples she discusses. Anderson thinks that market relations can be characterized by the following norms:

1 they are impersonal;
2 everyone is free to pursue his personal advantage;
3 the goods traded are exclusive and rivals in consumption (i.e., they are private goods);
4 valuations are purely subjective or want-related (rather than deriving from need or objective quality);
5 in case of dissatisfaction one replies by "exiting" rather than "voicing" one's complaint.

To give a stereotypical example of what she means, consider someone buying a new laptop computer. The purchasing act or relation is characterized as follows:

1 *Impersonality*. These days, most of us will go to the Apple store and buy the preferred model quite independently of who is selling it to us; we don't have personal relations with the vendor that make us buy the computer or this rather than that model.
2 *Personal advantage*. One buys the computer out of self-interest, not for the fulfilling of so-called "higher goals" such as world peace and justice; and there's nothing wrong with that.
3 *Private goods*. A computer is a private good: if I work on it, no one else can; Apple controls who the company is selling computers to. (There are obvious network externalities involved in the use of computers but we'll ignore these here.)
4 *Subjective valuation*. My having the computer might make me better off in some objective sense but what counts is that I wanted the computer; that's what makes the purchase one that is good for me.
5 *Complaints are made by exiting*. If the Mac turns out to be too easy to use after all, if one enjoys working around the bugs Microsoft builds into its applications and their slow, aesthetically unpleasing and convoluted user interfaces, one simply reverts back to a Windows-operated machine: one does not complain to Steve Jobs, God bless him.

Economic goods are simply goods whose exchange is properly governed by these norms. Anderson now simply but very insightfully argues that there are goods that, when traded in a setting characterized by (1)—(5), do not fully realize their value. That is, there are goods whose value cannot be fully realized through market exchange: there are goods that are not economic goods. She considers two kinds of goods in particular: gift goods and shared goods.

Gift goods are characterized by features that contrast with the first two norms of market exchange: intimacy and commitment. Typically, economic goods are produced for "the market," not in response to an individual's needs or personality traits. Even when goods are "customized," as many are today, this happens for the sake of increasing sales, not primarily in order to respond to someone's needs and characteristics. Gifts, by contrast, are supposed to do just that. Even though we all know that gifts often tell us at least as much about the gift-giver as they tell about the receiver, it is clear that a goal pursued by gift-giving is to respond to the receiver's needs and characteristics. Impersonal gifts aren't very nice gifts.

Moreover, gift-giving is an expression of a more long-term relationship. Typically, one does not give gifts to strangers, but if one does one is met with suspicion. I, for one, never accept offers of drinks from strange women in bars—what if they have less than perfectly honorable intentions? Both gift and market exchanges are reciprocal, but reciprocity is of a one-shot, immediate nature in market exchanges and of a repeated and long-term nature in gift exchanges. Misunderstanding the long-term nature of the reciprocity involved in gift exchanges is met with incomprehension and feeling offended. In another episode of the series *Frasier*, Daphne, the healthcare worker, gives Martin, Frasier's father, a cardigan for no apparent reason—she thought he might like it and uses the gift as a means to express her caring for him. Martin understands the reciprocal nature of gift-giving but thinks reciprocity is immediate. So he's hardly tried on the cardigan when he goes off to the shop to get Daphne a basket full of her favorite toiletries. Daphne hesitates and the following dialogue ensues:

MARTIN: Daphne, will you please just take the damn basket?
DAPHNE: Well, what are you getting so cross about?
MARTIN: Well, what? You can give me a gift but I'm not allowed to give you one back?
DAPHNE: Oh, so that's the only reason you gave me this?
MARTIN: Yeah, that's the way it works.
DAPHNE: Well, where I come from you don't just give someone a gift because you have to. Here, take your silly basket.

Gifts lose their character if they are not exchanged in a way compatible with the norms of intimacy and commitment. On the basis of these considerations, Anderson criticizes a range of social practices that involve market exchanges for goods that should properly be exchanged by gift relations:

prostitution, exploitative manipulation of gift relations in commercial transactions, marriage contracts and loans between friends.

Anderson also addresses what she calls "shared goods." Apart from market and gift relations, people have also fraternal relations. These obtain when individuals agree to refrain from making claims to certain goods that come at the expense of those less well off than themselves and when they regard that achievement as part of their own good. Political goods are an example. These are characterized by norms of exchange that contrast with market norms (3)—(5): they involve important (usually, positive) externalities, they are distributed in accordance with principles and needs rather than wants, and freedom is exercised through voicing one's complaint rather than exiting.

It is harder to find unequivocal examples in this area but national defense might constitute one. National defense is clearly a public good: once produced, it is impossible to exclude any citizen from benefiting, whether she wants it or not; and any one citizen's "enjoying" of the good does not stop any other from doing the same. It would be quite peculiar to argue that the decision to introduce, maintain or give up national defense, and to determine its goals and operative assignments, is a matter of citizens' personal tastes; rather, it should be a matter of well-reasoned principle. And if, as a citizen, we do not accord with the adopted principle, we should voice our disagreement through the political process or public protest. "Exit" is not usually an option, and when it is, it constitutes an inadequate response.

As before, Anderson criticizes certain social practices on the basis of the preceding considerations. Certain goods such as the provision of public roads and spaces, the provision of welfare benefits and of primary education are more like national defense than like computers. If all roads and public spaces were privately owned, we'd lose spaces for expressing our political views in demonstrations and campaigns; certain forms of welfare provision should be made in kind rather than in cash because we, as a community, value them highly: thus, a benefits recipient should not be given the opportunity to opt out of health insurance and get the equivalent in cash because health is too important a good; school vouchers are generally a bad idea because they encourage the formation of specialized schools and lead to parents "choosing" the school they deem appropriate for their children rather than exercising their democratic right and duty to contribute to values and curricula taught at schools.

Now, we certainly did not need Elizabeth Anderson to remind us that prostitution is different from matrimonial sex (and a one-nighter different from sex as an expression of "intimacy and commitment," for that matter). But she points to an important phenomenon which should make us worry about tendencies we currently find in many Western societies. The phenomenon is that there is more than one way to enjoy a good, and our ability to enjoy a good in a given form depends in part on the way in which it is exchanged. A gift that does not respond to its recipients' needs and personality traits, and that expects immediate reciprocation ceases to be a gift. A society in which the school system is balkanized and parents express their political views only through choice has a harder time building a democratic tradition than one in which every pupil attends public school and parents decide about values and curricula in common.

The tendency we find in many Western societies is that more and more spheres of our lives are subject to market principles. I began by giving a number of examples, so let me end this discussion of the argument from corruption with a final example. University education used to be free or come at a symbolic "registration fee" in many countries. More and more governments now make public universities charge tuition fees which are often considerable. There is an economic argument behind this practice: university graduates have, on average, higher salaries, and it is only fair that they should pay for the cost of the investment in their human capital. Education has some externalities, to be sure, but that only means that the public should subsidize education, not that it bears the full cost.

Tuition fees affect students' expectations about university education. They're paying for it, so they expect to be treated like customers. For the same reason they treat their educators as service providers. They also expect to get good grades: "I paid a lot of money for my grades, so they had better be really good!" But students are no customers and university teachers no service providers. Grades should not reflect the amount of money paid for the tuition but the quality of the student's performance. The content of curricula should not respond to student preferences but be determined on the basis of principles such as academic excellence and students' needs. Tuition fees corrupt students.

Everything said so far should be fairly uncontroversial. The real question is what to do about it. Where do we put a stop to the tendency for more and more spheres of our lives to be characterized by market relations? Shall we prohibit the sale of some goods altogether? These are hard questions, and there is no space here for me to try to provide an answer. Let me just say this much: the argument from corruption does not, by itself, provide a good reason to prohibit trade in some good. It is true that exchanging gifts using the norms of the market corrupts the nature of the gift good. We can't enjoy something as a gift if it is impersonal and comes with a call for immediate reciprocation. But that doesn't mean that there is anything wrong with a good exchanged in that way. Think of the British practice of buying drinks in rounds rather than individually. Here the reciprocation is pretty immediate: you buy your round when it's your turn. And the buyer of the round hardly responds to the needs and traits of the other drinkers—at least not to a degree characteristic of gift exchange. According to Anderson's schema, "rounds" are an economic good in British pub culture. And yet I fail to see what is wrong with it, or what could be gained by organizing it such that it more closely resembles typical gift goods.

My core point is that exchanging goods via market principles is not harmful as long as there are avenues for other kinds of exchanges (cf. Wolff 2004).

We'd live in an impoverished world without gifts and common goods. But of course it is also true that we'd live in a literally much impoverished world if there were no economic goods. And other than extreme conservatism I don't see a reason to believe that all goods should come with an *a priori* knowable, unique "proper" or "adequate" form of exchange. Luckily for the critics, there is an arrow left in their quiver.

The Utilitarian Argument

The utilitarian argument says that replacing other forms of exchange by market exchange can be welfare-decreasing. It is closely related to the second argument and can therefore be discussed quite briefly. The story is this. Take a good for which there is a shortage of supply: organ and blood donations, punctuality, quiet on the part of students during classes. Think like an economist and introduce monetary incentives in order to stimulate supply. Observe that the opposite happens: supply actually goes down. Ask yourself, what has happened? Answer: the existence of monetary incentives crowds out certain forms of intrinsic motivation. Since market exchange may corrupt a good (see above), people are less inclined to supply it. Then, when monetary incentives are not strong enough to fully replace or surpass the original motivation, supply will go down.

This argument is based on a famous study by Richard Titmuss (1970). Titmuss compared the US and UK systems for procuring blood and argued that the UK system of donated blood was superior not only in quality but also in efficiency to the US system, which allowed blood to be bought. He argued that unlike the UK's altruistic donors, the US sellers have a reason to conceal illnesses, and so the quality of marketed blood should be inferior. He further claimed that the introduction of markets "represses the expression of altruism [and] erodes the sense of community" (Titmuss 1970: 314). Actions formerly based on "higher motives" now have a price tag. "Higher motives" often provide a better incentive than money, and therefore the willingness to donate decreases.

The beauty and strength of the argument lies in its claim that it is the pure existence of a market exchange that crowds out intrinsic motivations; it does not depend on the market taking over other forms of exchange completely. But it is also an *a priori* argument whose significance relies on it actually being the case that the introduction of markets decreases welfare by crowding out intrinsic motivations.

There is some evidence that the mechanism Titmuss describes is sometimes in place. Debra Satz describes one famous experiment:

> Faced with parents who habitually arrived late to pick up their children at the end of the day, six Haifa day care centers imposed a fine for such parental lateness. They hoped that the fines would give these parents a self-interested reason to arrive on time. The parents responded to the fine

> by doubling the amount of time they were late. Even when the fine was revoked three months later the enhanced lateness continued. One plausible interpretation of this result is that the fine undermined the parents' sense that they were morally obligated not to take advantage of the day care workers; instead they now saw their lateness as a commodity that could be purchased.
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> (Satz 2010: 193)

But, as Satz also observes, whether the introduction of markets actually does crowd out intrinsic motivation, thereby reduces the supply of important goods and thus decreases welfare or whether financial incentives provide the expected stimulus is an empirical one that has to be addressed on a case-by-case basis. Once it mattered, from grade 10 or so onwards, my parents gave me money for good grades. That was the only way to get me to try to improve my academic performance and it worked. I am eternally grateful to my parents for not having known about Titmuss *et al.*

In sum, the utilitarian argument is inconclusive. It simply depends on empirical facts that cannot be settled by philosophical argument. I do not get the feeling that the existence of prostitution has a negative effect on the exchange of sex according to the norms of gift exchange, that the existence of private or confessional schools crowds out parents' motivations to contribute to the life of public schools or that paying some kids to perform better at school eliminates all nerds. But one should certainly introduce markets for "goods" such as kidneys if at all only after a careful study of the relevant empirical facts (which of course also include facts about the outside options of potential donors/sellers; see above) and consideration of the moral issues involved.

Study Questions

1. Think about the things you consume in the course of a normal day. How many of them are purely private goods? How many are public goods?
2. What solutions are there to the problem of externalities? Which one do you find most convincing?
3. Should there be property rights and how strong should they be? Justify your answer.
4. Are there goods the market exchange of which is always unfair?
5. How convincing do you find the utilitarian argument against market exchange? Defend your answer.