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When Individual Preferences Defy Sustainability — Can Merit Good Arguments Close the Gap?

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ABSTRACT

In this paper, we discuss how merit good arguments may contribute to discussions about sustainability. To this end, we clarify how merit good arguments deviate from individual preferences and relate the justification for deviations from individual preferences to two conceptions of well-being: an informed preference satisfaction and a perfectionist conception. Building on this framework, we analyze how merit good arguments can be helpful for discussing sustainability as justice, what challenges merit good arguments pose to future generations, and whether they can serve as a normative justification for green nudges. The analysis yields two main insights. First, a reflection on the concept of merit goods is helpful in sorting out the different justifications that sustainability interventions may rely on. In particular, it allows separating the challenges of redistribution, internalization of externalities and increasing individual consumption of particular (merit) goods such as health care or education more clearly. Second, the precise notion of merit goods by itself, however, only offers a limited contribution and does not represent a blank check to justify deviations from individual preferences.

1. Introduction

Sustainability, defined in terms of intra- and intergenerational justice (e.g. in Baumgärter and Quaas, 2010) goes beyond the internalization of externalities. Moreover, individual preferences need not necessarily facilitate sustainability, which leads to the question of how this gap can be bridged (e.g. Pezzey, 2004; Bullock and Collier, 2011). Thus, one crucial issue for sustainability economics consists in reflecting on the appropriate scope of and justification for policy interventions that deviate from individual preferences.

Within this context, the concept of merit goods, originally introduced by Richard Musgrave (1957, 1959), may be helpful — for merit good arguments posit preferences that deviate from individual preferences for some specific good: Musgrave describes merit goods, somewhat vaguely, as a situation "where evaluation of a good (its merit or demerit) derives not simply from the norm of consumer sovereignty but involves an alternative norm" (Musgrave, 1987: 579). For instance, merit good arguments justify government intervention on education, arts and healthcare in an allocation that is Pareto-efficient and equitable, i.e. without distributive concerns (Andel, 1984). To see this, consider the case of health care: many governments highly subsidize health insurance, particularly for older people, to improve public health beyond what people would purchase by themselves. A policy based on purely economic rationale would contend itself with correcting informational asymmetries so as to equate marginal cost and benefit of health care.[1]

Against this background, it might be argued that merit good arguments offer such justifications in the case of sustainability as well. Indeed, Rogall (2013: 558) claims that merit goods pose an essential conceptual foundation for sustainability economics. However, the literature reveals only very few specific links. For instance, there has been made the case for organic food as a merit good (Mann, 2003) on the grounds that market demand does not yet match the reflective or informed preferences for organic food. But mostly, merit good arguments are only made implicitly, without actual reference to the

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[1] Certainly, health care policies also reveal striking national differences: within the US political culture, health insurance seems to be considered much closer to an ordinary economic good that needs to be individually earned, as compared to much of Europe where access to health insurance figures rather as a societal value than a consumptive good.

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conceptual discussion, such as in the case of education for "mindfulness", which is argued to "contribute both to more sustainable ways of life and to greater well-being" (Ericson et al., 2014: 73). On a general level, then, this paper aims to assess what specific contributions merit good arguments may offer for discussions of sustainability.

To this end, the paper reviews two fundamental questions that are well known from the public finance literature (Musgrave, 1987; Goodin, 1989; Dasgupta, 2005): the first question concerns the conception of well-being in merit goods, i.e. why do merit goods make people better-off beyond their contribution to individual utility? The second question concerns the justification of paternalist policies, i.e. why are government policies that are not based on individual preferences justified? These questions obviously pertain to discussions of sustainability as well. The first question on conceptions of well-being is relevant for sustainability criteria that compare future and present well-being. For example, one common criterion states that the future should not be worse-off than the present, i.e. that utility should be non-decreasing over time (Pezzey, 1997). Then the question becomes whether and how merit good arguments and their conceptions of well-being allow such comparisons of well-being between future and present generations.

The second question on the deviation from individual preferences directly relates to government interventions in the name of sustainability. With regard to environmental issues there is a growing literature that applies insights from behavioral economics to influence individual behavior such as green nudges with default renewable electricity contracts (e.g. Sunstein and Reisch, 2013; Croson and Treich, 2014). For instance, the British "nudge unit", a social purpose company partly owned by the UK government, aims to "to encourage people to make better choices for themselves and society" in a variety of fields, such as health and safety.[2] However, such interventions in the name of Libertarian Paternalism (Sunstein and Thaler, 2003) are controversial. Interestingly, within this debate critics of even soft interventions ("nudging") stand against proponents of much stronger policy interventions to foster sustainability (e.g. Schnellenbach, 2016; Dobson, 2014). This discussion on the justification of paternalist policies and the merit good literature can inform the general debate on sustainability policy and individual choice.

In what follows, we (i) clarify the definition of merit goods by considering the model for merit good arguments in Besley (1988), (ii) we build on the work of Goodin (1989) and discuss two conceptions of well-being that can serve as an underpinning for merit good arguments, and (iii) discuss what challenges and opportunities merit good arguments raise vis-a-vis the discussion of sustainability problems. The paper is structured as follows: Section 2 discusses the history of merit goods, provides a definition of the term and introduces a simple economic framework to give a more analytical structure to the argument. Section 3 examines conceptions of well-being behind merit good arguments and associated justifications for paternalist policies. Section 4 discusses the challenges and opportunities of merit goods in an intergenerational framework and sustainability discussions. Section 5 concludes the discussion.

2. History and Definition of Merit Goods

Richard Musgrave introduced the concept of merit goods in two early contributions in 1957 and 1959. Despite the long history and broad use of the concept since then, confusion around the definition of the concept remains. In his article for the New Palgrave Dictionary of Economics, he concludes that "[i]n all, it seems difficult to assign a unique meaning to the term" (Musgrave, 1987: 581). Andel (1984) traces the development and changes of the definition of merit goods in Musgrave's works. He criticizes two aspects in Musgrave's use of the concept. First, the given examples involve arguments for government intervention that are independent from merit goods: externalities, which justify Pigouvian taxes, and redistribution, which justifies redistributive taxation and transfers. Therefore, the examples do not serve particularly well to explicate the specific argument for government intervention behind merit goods. Second, he criticizes that Musgrave's use of the concept changes between a normative theory, that people should consume higher amounts of merit goods, to a positive one, that explains why governments subsidize specific merit goods, e.g. due to paternalist altruism that targets specific goods (Andel, 1984: 637). Andel concludes that due to the confusion around the concept, merit goods are mostly used for the case of a social planner who increases the consumption of some good due to a variety of arguments (Andel, 1984: 648). This leads us to define merit goods broadly as:

Definition 1 (*Merit good*). A *merit good* is a good for which the preferences a social planner prescribes differ from actual individual preferences.

This definition distinguishes merit goods on the one hand from externalities and public goods and on the other from distributive concerns. Further, it says that a social planner can disregard individual preferences in the case of a merit good.

Despite this vague definition, merit good arguments have made their way into some parts of microeconomic theory such as optimal taxation (e.g. Besley, 1988; Schroyen, 2005; Blomquist and Micheletto, 2006; O'Donoghue and Rabin, 2006; Schroyen, 2010) and the discussion on paternalism in behavioral economics (e.g. Schnellenbach, 2012). Also, in his discussion of the normative foundation of economic analysis, Partha Dasgupta refers to merit goods as an established concept for situations where policies are justified independently from individual preferences (Dasgupta, 2005). In this way, merit goods are invoked in many applied areas: in subsidies for organic farming (Mann, 2003), water supply and sanitation (Schwartz and Schouten, 2007), the role of social impact bonds in health care (Fitzgerald, 2013), subsidies on art and culture (Soh, 2011), housing subsidies (ter Rele and van Steen, 2003) or sin-taxes on alcohol or sugar to fight unhealthy lifestyles (e.g. O'Donoghue and Rabin, 2006; Schroyen, 2010).

In order to give more structure to Definition 1, we will use the model for merit goods in Besley (1988) for clarification. For this, consider an economy with two goods and at least one representative individual i where x_i is the amount of a normal good and y_i the amount of a merit good consumed by individual i. Assume a *utility function* of individual i, based on its actual preferences, which is increasing, strictly quasi-concave and twice continuously differentiable for both goods:

$$U_i(x_i, y_i) \tag{1}$$

In welfare economics, this utility function is usually taken to reflect individual choice as well as an index for the evaluation of individual well-being (Hausman and McPherson, 1993: 680). This means that according to U_i every individual choice makes the individual better-off.

With merit goods a social planner respects the individual's choices for good x_i, but prescribes different preferences for the merit good y_i. In Besley's (1988) model, this difference leads to, what we call, the *merit utility function* of individual i, based on merit preferences from a social planner for good y_i.

$$V_i(x_i, y_i) := U_i\,(x_i, \mu_i(y_i)) \tag{2}$$

[2] http://www.behaviouralinsights.co.uk.