

# Merit goods

Péter Cserne<sup>1</sup> and Maxime Desmarais-Tremblay<sup>2</sup>

## Full Reference

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## Introduction

The German-born Harvard economist Richard A. Musgrave (1910–2007) introduced the twin concept of merit wants and merit goods to the economic analysis of the public sector. When he coined the name “merit goods” in 1957, he pointed out that certain goods such as free school lunches or subsidies to low-cost housing did not have the characteristics of a pure public or private good. If a government is dissatisfied with the level of consumption of such goods in the free market, it may intervene to increase consumption, even against the wishes of consumers, to promote their private, as well as some social interests. Musgrave noticed that a term was missing for this domain which could not be described in terms of either private or public goods, although he acknowledged that, e.g. in education, there was an overlap between public (what he called social) and merit wants.

The topic of merit goods is relatively marginal in economics; most of the relevant literature produced in the first 60 years is available in a sizable anthology (Ver Eecke 2007). This collection, however, has arguably generated further interest in the topic. The last 10 years saw important new contributions, linking the discussion on merit goods not only to behavioral economics and nudges but also to historical and heterodox schools of economic, political and social thought. One of the founding fathers of the Law and Economics movement, Guido Calabresi has recently suggested integrating merit goods into legal-economic analysis (Calabresi 2016, see also Desmarais-Tremblay 2019b).

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<sup>1</sup> School of Law, University of Aberdeen, [Peter.Cserne@abdn.ac.uk](mailto:Peter.Cserne@abdn.ac.uk)

<sup>2</sup> Institute of Management Studies, Goldsmiths, University of London, [M.Desmarais-Tremblay@gold.ac.uk](mailto:M.Desmarais-Tremblay@gold.ac.uk)

## **The Concept of Merit Goods in Musgrave's Work**

In the 1950s, Richard A. Musgrave (1957, 1959) introduced the concept of *merit wants* in the theory of public finance to refer to individual needs for which the government often provides goods and services beyond what the market provides because these needs are of high social importance (Desmarais-Tremblay 2017). In the 1960s, such goods and services came to be known as *merit goods*. Musgrave argued that these goods, while not genuine public goods, are (and should be) produced or provided publicly and consumed mandatorily, irrespective of individual preferences. The twin concepts serve to formalize the welfarist idea of paternalism with regard to certain publicly provided or publicly subsidized goods.

The list of merit goods discussed or suggested by Musgrave is rather long and diverse (see Ver Eecke 2013, p. 36 n. 4), including social housing for the poor, school milk, health services, funding for the arts, and provisions for the protection of natural and cultural heritage. Musgrave (1959, p. 178) also raised the possibility that governments have a responsibility to regulate the consumption of *demerit* goods such as alcohol, tobacco, or prostitution.

Some of Musgrave's broader formulations of the idea include cases of regulation or public expenditure which are now covered by mainstream economic categories of market failure. Thus, merit goods often have some public good characteristics (non-rivalry and non-excludability). Their provision can sometimes be justified by externalities or asymmetric information. Sometimes, they coincide with or are driven by redistributive concerns. However, Musgrave (1987) insisted that there can be a number of further reasons, independent of standard economic arguments for overriding individual preferences.

Although Musgrave occasionally referred to ideas of political philosophy, including Rawls (1971), he failed to clearly explain the normative theory underpinning merit goods as a distinct kind of goods to be provided through collective decision (Desmarais-Tremblay 2021a). His main ideas are sufficiently clear though, at least in the context of modern democracies and mixed economies. For Musgrave, considerations of social welfare can legitimately override 'autonomy' only if they are (directly or indirectly) supported by the people. At least in part, their normative justification is political: the legitimacy of public provision of merit goods relies on some implicit conception of collective sovereignty. Musgrave rejects the idea of a benevolent despot implementing the provision of merit goods. Even if people might not always know in detail what is good for them, policies have to be framed in a way that they could be accepted by the population under ideal conditions of deliberation (Desmarais-Tremblay 2019a).

## **Merit goods in Economics: Between "Consumer Sovereignty" and Paternalism**

The idea of merit goods proved both enigmatic and controversial in economics. The most influential criticism was put forward by McLure (1968), a prominent scholar of public finance and former student of Musgrave. McLure contended that merit goods had no place in Musgrave's framework. Even if the concept could capture existing public expenditures, it could

not be justified in a normative economic theory of the public sector. Indeed, it is far from obvious how merit goods fit into the normative assumptions and the conceptual framework of mainstream economic thinking and how they can be represented in mathematical models.

As for substantive issues, mainstream economics is based on the ideal of consumer sovereignty and freedom of choice. For markets to function as a domain of free interaction and to bring about social welfare, an institutional framework is required (roughly, property rights should be well defined, contract enforceable, anti-competitive behavior prohibited), and various market failures may require further intervention. These include negative externalities (uncompensated harm to third parties), cases where individual decisions lack rationality and/or autonomy, public goods which cannot be produced or provided through private market transactions. Yet, any government intervention in response to market failures may end up in a government failure, thus making non-intervention superior overall.

In the British line of utilitarian economic thought, as formulated or inspired by JS Mill and H Sidgwick, social welfare maximization does not categorically rule out overriding individual preferences. Mill explicitly argues for paternalistic interventions (i) when the individual is not the best judge of his interest, and (ii) when unorganized self-interested behavior does not lead to the greatest social welfare (Mill 2006 [1848] V.11, see also Medema 2009, Chapter 2).

In the United States, both early 20th century progressive institutionalist economists and left liberals of the 1960s argued for policies that, through collective provision of or subsidies for education, infrastructure, community services, would aim to increase the level of consumption. In this view, government intervention is justified by the unfulfilled wants of the people (Hansen 1947, p. 167, see also Galbraith 1958).

Other economists such as Head (1969) tended to move merit goods analysis towards a version of soft paternalism which in turn can be formalized in mainstream or behavioral economics as a regulatory intervention responding to information failures or cognitive and emotional biases of individuals. Head argued that, properly understood, the provision of merit goods does not actually interfere with consumer sovereignty.

Some economists have suggested broadening the concept of individual preferences to explain how non-optimal choices or inconsistent choices might in fact reflect an internal tension between lower-level preferences and higher-order preferences. Merit goods could be goods demanded by individuals when they are given the opportunity to reveal their higher-order preferences (for a concise summary of this perspective, see Clément and Moureau 2018).

Recently, Sunstein and Thaler (2003) initiated a normative or ideological project of libertarian paternalism and suggested regulatory tools for designing choice architectures (nudges) to promote individual interests while maintaining freedom of choice. This has generated a fast-growing body of literature which occasionally refers to Musgrave's concerns and concepts as well (Munro 2009, Mann and Gairing 2012, Sturn 2015, Kirchgässner 2017). In fact, White (2019) argues that "nudges can be considered delivery mechanisms for merit goods" which in turn can be justified by objective rather than subjective interests.

As far as formal modeling is concerned, at first sight it seems that merit wants and merit goods cannot be represented by individual utility functions. Some suggested that they should be modeled as a special type of externality. Yet, as a conceptual matter, to talk about merit goods only makes sense if a government (some decision-making body “representing” society) exists. The Bergson-Samuelson Social welfare is a typical way to formalize such a social perspective. In line with economists’ concern for individual autonomy, Paul Samuelson posited that social welfare functions would generally be individualistic, that is they would value social welfare only through the individuals’ own valuation (utility function). Departing from this assumption, Pazner (1972) suggested representing merit goods by non-individualistic social welfare functions. Formally, merit goods would be goods that enter as direct arguments in the social welfare function, independently of how they are valued in the individual utility functions.

In other words, “in the case of merit wants or goods, the welfare function that the policymaker is supposed to maximize on behalf of the individuals is modeled in a way that it is formally different from how the individuals in question themselves are modeled to perceive and reveal their preferences. In this approach, consumer sovereignty is openly questioned and abandoned in favor of a policymaker's supra-individual assessment as to how much of certain “merit goods” should be provided to and consumed by individuals.” (Cserne 2012, 36-37)

In brief, merit goods can be rationalized in terms of social choice theory where individual market choices are overridden in the name of what a particular (political) community considers worthwhile for individuals to do (consume). This formulation, however, is ambivalent.

In one interpretation, social choice is taken to represent collective decisions. The introduction of merit goods in a social welfare function brings the analysis close to a paternalistic justification for deviating from consumer sovereignty. In another formulation, individuals’ *political* preferences (as expressed through voting) conceptually differ from and may legitimately override their *market* preferences as expressed through consumer decisions (Brennan and Lomasky 1983). The broad idea is that “individuals work with different preference maps depending upon the context in which they exercise their preferences.” As voting citizens or paying customers, “individuals prefer different things in different institutional settings.” (Ver Eecke 2007, 2) In this way, social choice represents (aggregates) individual political preferences. These political preferences, in turn, may be seen as the higher-order preferences overriding the first-order (market) preferences.

Merit goods suggest refining the analytical tools of normative economics and redefining the concept of paternalism in order to fit the latter in the methodological framework of the discipline. Yet the concept of merit goods is difficult for economic theory to absorb because it suggests that there are values over and above individual preferences, and that such values may actually supersede consumer choice. The substantive tension remains and the concept of merit goods clearly and almost openly demonstrates the fundamental conflict between autonomy and welfare and solves it in favor of welfare, broadly understood.

## **Merit goods Within and Beyond Normative Individualism: Connections to Social and Political Philosophy**

Both Musgrave's hesitancy to adopt and justify a supra-individual metric of welfare and the ambivalent reception of the idea in economic literature reflect the unresolved tension between a libertarian and a utilitarian normative stance in economics. As such, it is not surprising that economics is ill-equipped to handle the problems which arise when these two principles collide. Merit goods, in turn, can be interpreted in both ethical-political frameworks.

The traditional normative stance of economic approach is a non-reflexive mixture of liberalism and utilitarianism. The starting point of both stances is normative individualism, the idea that collective decisions should, as a rule, be based on individual preferences. Yet, on occasions there is good reason to overrule these preferences or at least not to give them effect in public decisions. Economics has striven to justify instances of reasonable, seemingly paternalistic regulations in several ways, often deliberately avoiding the term 'paternalism'. Policies where individual preferences are overruled in the name of or with reference to some moralistic paternalism or communal idea of the good can be analyzed through this conceptual route.

In fact, the idea of collective decisions overriding individual preferences, as expressed in market decisions, resonates with several non-mainstream traditions in economic and social thought. Thus, the concept of merit goods provides an analytical tool for integrating economics with heterodox, in particular non-individualistic, or philosophical, in particular aretaic (virtue-based) approaches (Ver Eecke 1998, Cooter and Gordley 1995).

The idea of a welfare state, in its Bismarckian version in late 19<sup>th</sup> century Germany, could accommodate certain "communal wants and obligations" even more easily. Some collectivist and even organic notions of the State would underpin the moralistic and paternalistic role of the government in providing education, social welfare to those unable to work. German-writing economists were usually critical of the fiction of the selfish Economic Man which led them to conceptualize that an ethical state could spring from the interaction of other-regarding community driven individuals. German scholars such as Adolf Wagner had a profound influence on early twentieth-century public finance theory, and especially on Musgrave. Wagner observed that public expenditures were increasing in Western countries and rationalized this trend as a civilizing mission of the State. This was part of the intellectual background against which Musgrave coined the concept of merit wants (Desmarais-Tremblay, 2017, 2021b).

Thus, when looking for solid philosophical foundations to merit goods, Ver Eecke (1998) tried to rationalize them in terms of Kantian and Hegelian practical philosophy, arguing that "[t]he necessity of politically imposed institutional arrangements for the economy to function well and humanely demonstrates the validity of Hegel's claim that the economic domain is an ethical arrangement." (1998, 133)

Others reconstructed the idea of merit goods in broadly (neo-)Aristotelian terms, linking them to “irreducibly social goods” (Taylor 1990). This, in turn, usefully links merit goods to the powerful ancient idea of the common good (Mastromatteo and Solari 2014). The common good is a regulative force applying both to individual and governmental action. It concerns the political order of society. This approach conflicts with the normative primacy of fixed individual preferences, dominant in economics, to the extent that it recognizes the collective construction of individual aspirations and the resulting need for ethical deliberation in order to elaborate social policy. Note that “the collective construction of individual aspirations” goes beyond the aggregation of individual preferences, referring to bringing together different hopes, dreams, visions of the collective.

Putting aside the market failure approach to government intervention “the reference is not the perfect market allocation but is the political conception of good life. The consequence is that the government of a community has the duty to identify what merit good is needed to improve the socio-economic conditions of the community according to what is good for man.” (Mastromatteo and Solari 2014, p. 97)

Furthermore, the concept of primary goods in Rawlsian political philosophy (Rawls 1971) and capabilities in Amartya Sen’s (1980) theory seem to resonate with Musgrave’s intuitive and underdeveloped philosophical ideas behind merit goods as well.

By elaborating these philosophical connections, merit goods could provide entry points for normative arguments into welfare economics which would enrich the discourse that seems to be stuck between rigid extreme positions yet lack the analytical tools for moving beyond them. The affinities of Musgrave’s analysis with these various schools of thought suggest potential overlaps and opportunities for a fruitful dialogue with legal and political philosophy.

## **Conclusion**

Musgrave coined the terminology of merit wants and merit goods in the context of public finance or public decision-making, i.e. with reference to a domain that, for both laymen and the philosophically minded, seems to be logically linked to the public (common) good. The intuitive plausibility of this link rests on normative ideas that, however, can only be clumsily grasped by mainstream economic theory which tends to reduce all normative concerns to individual preferences. In fact, within mainstream economics, the domain of public finance is necessarily approached with the same methods as any other domain of the economy or perhaps of social life. This methodological stance implies some tension between the normative ideas and the standard conceptual tools of economic thinking about public finance as well as a need for interaction between economic and philosophical discourses on the public good. While the concept of merit goods has played a minor role in modern economics, it has the potential to both reveal the continuity with earlier collectivist conceptions of economic and political life and to open the stage for ethical discourses which go beyond rigid versions of libertarianism and welfarism. Hence the continuing relevance of Musgrave’s conceptual innovation for social and political theorizing.

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