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Merit Goods

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Definition

Merit goods are a category of goods, introduced in the debate by Musgrave (1957), that individuals tend to under- or overconsume because their preferences are “irrational” or “defective.” This leads individuals to make suboptimal choices, which are detrimental to their well-being. Now, if they exist, merit goods must be produced by the government that must so to speak force individuals to consume the correct amount of these goods. In other words, the government must behave paternalistically.

The concept of merit goods was a precursor to the debates on paternalism within welfare economics. In particular, the interpretation of the merit goods concept through the meta-preferences approach helps legitimizing legal intervention and achieving a more efficient regulation.

Musgrave’s Breach in Welfare Economics

When Musgrave introduced the term “merit goods” (originally called merit wants), it was in an attempt to create a normative definition for government functions. Nevertheless, only three of the functions he studied in his article have gone down in history: (i) the provision of public goods (service branch), (ii) the redistribution of income (distribution branch), and (iii) economic regulation (stabilization branch). Yet, in this groundbreaking article, Musgrave also mentioned another category of goods which he called merit wants. He was referring to goods which are subject to “transfers in kind” (for example, social housing) and for which the regulator’s preferences override individual choices (Musgrave 1957 p. 341).

In 1959, Musgrave returned to this concept of merit goods by explicitly linking it to the issue of consumer sovereignty (Musgrave 1959). In some cases, when choices made by people on the markets do not lead to a situation that maximizes their well-being, the regulator intervenes in order to address the limitations of individual preferences and correct people’s choices in their own best interest.

It is nevertheless in his 1987 Palgrave article that Musgrave strengthened the definition he had introduced 30 years earlier. He clarified two points in particular which attracted most comments since they were first published. Firstly, Musgrave confirms his initial theoretical claim that the justification for government intervention through merit goods is distinct from that linked to market failures and redistribution. Indeed, while links between merit goods, public goods, and externalities may have caused some confusion in his initial papers (Head 1966; Head 1969; Ver Eecke 2001), the Palgrave article provides clarification. In no way should merit goods be confused with public goods or externalities. Whereas in the case of public goods, there is a link between consumers’ willingness-to-pay and consumption levels, this link is broken in the case of merit goods. Furthermore, merit goods refer to situations where people’s choices are detrimental to their own well-being without third parties being involved, as is the case with externalities. Secondly, at the heart of the definition of merit goods lies the fact that if choices are detrimental to individual, it is because their current preferences are defective. Thus, choices then expressed in the market no longer equate with

welfare. These individual failures could justify government interventions (Jones and Cullis 2002).

The reasons why choices made on the market may lead to a suboptimal situation have been the subject of extensive debate. In the article he wrote for the *Palgrave Dictionary*, Musgrave takes the view that situations in which people voluntarily delegate their choice to a more informed party, in a principal agent relationship, do not relate to merit goods. However, in his early works, he did not take this stance and had in fact used education as a prime example of merit goods. Indeed, at first, he considered that the reason why education was compulsory was because people were not able to forecast the profit, they would earn of such an investment. He nevertheless changed his mind, stating that it was simply an information issue encountered by the individual which justified a delegation of choice to another better-informed party (Musgrave 1987; West and McKee 1983).

Defining the concept of merit goods is rather about highlighting the inconsistency of the preference standard in order to form judgments on individual well-being. Hence, it seems that even when full information is available, wrong choices can be made and lead to a suboptimal situation for the individual. By definition, merit goods infringe on consumer sovereignty, and for this reason, they were excluded from the standard welfare economics framework as the gold standard for paternalism (McLure 1968). However, there have been attempts to model merit goods in the context of welfare economics (Pazner 1972; Roskamp 1975; Wenzel and Wiegard 1981; Salanié and Treich 2009). These attempts perhaps reflect the need to justify an extremely widespread regulatory practice. For example, OECD data shows that two-thirds of European government bodies expenditure are somehow justified in terms of merit goods (Fiorito and Kollintzas 2004) and cannot be explained by standard market failure arguments.

If current short-term preferences are disqualified, the question arises of how “authentic” preference could be defined and what it stands for. The theoretical issue underlying this question lies in the possibility of articulating merit goods with the classical liberal principle of normative individualism. Musgrave did not evade the issue. In some of his papers, he noted that there is an elite who is in a position to know people’s “true preferences” or “authentic preferences” (Musgrave 1969); in other papers, he refers to collective norms or “community preferences” (Musgrave 1987).

Another way to justify the concept of merit good in the economic framework, consisted in expanding the area of individual preferences beyond market preferences, displayed through the willingness to pay and choice, by introducing the notions of “multiple-selves” and “meta-preference.” The economic agent is then defined by a collection of different and independent personalities (Harsanyi 1955; Elster 1979; Etzioni 1986), each of which leads to a separate classification of available options. The individual is no longer a unified person and may struggle to control his behavior (Schelling 1984). Similarly, the individual may have the ability to evaluate and reflect on her own tastes and preferences, which is expressed through second-order preferences or meta-preferences (Frankfurt 1971; Jeffrey 1974; Sen 1977; Hirschman 1984; George 1998). These reflect the individual’s dissatisfaction with a choice that she has nevertheless made. The regulator then appears as a mediator between the preferences displayed on the market on the one hand, and the reflexive preferences on the other hand, this mediation then taking place within the framework of merit goods (Brennan and Lomasky 1983).

Merit Goods Revival Within Law and Economics

The idea of multiple levels of preferences makes it possible to consider decisions made by policy makers, legislators, and judges, as expressions of second-order preferences or meta-preferences. In this context, merit goods regulations achieve greater efficiency than those implemented by the market, while respecting the individualistic basis of collective choice. In this sense, the interpretation of Musgrave's concept through reflexive preferences is particularly relevant when analyzing economic policies and regulation policies within a law and economics approach. As noted by Kirchgässner (2017), this ties in with an important tradition in political economy and political philosophy which, from Buchanan and Tullock (1962) to Rawls (1971), combines the choice of a constitution or of the general principles on which society is organized with higher order preferences.

The question of the role played by merit goods in the economic framework remains topical with the development of libertarian paternalism (Sunstein and Thaler 2003). By exploring the flaws of reasoning and rationality, behavioral economics actually deepens the empirical content of Musgrave's argument for merit goods. Nevertheless, this strand of literature quite surprisingly did not refer to the concept of merit good in its developments of a new framework for regulation. Obviously, behavioral economists argue against interventions justified by merit goods argument as they represent hard paternalism restricting individual choices through law, rule, or taxation. Behavioral economists favor nudges, where the regulator helps people make the best choice by changing the choice environment so that there should not be any restriction of the available options provided by the market (Thaler and Sunstein 2008).

Actually, behavioral economics did not pay tribute to the contribution of the merit goods' argument to the normative justification for the government intervention. In this respect, the continuity with the pioneering concept of Musgrave is certainly to be found in the role and definition devoted to merit goods in law and economics following Calabresi (2016). Calabresi complements and extends the definition of Musgrave adding two reasons why merit goods should not be (and actually are not) allocated through markets: the refusal of the "commodification" and pricing of certain goods and the refusal of an allocation based on people's willingness to pay given the vast inequalities in wealth distribution in our societies. In the first category, people object to the use of monetary evaluation and measurement for being conducive towards unacceptable trade-offs; for example, trade-offs implying life or safety and money. The second category of merit goods following Calabresi includes those goods whose measurement in monetary term is no longer objectionable but people oppose the use of the pure market mechanisms because the allocation thus depends on the prevailing unequal distribution of wealth; examples are military service or the right to obtain body parts (blood, kidney...) or the right to a basic education. Taking seriously people's actual preferences embedded in these two merit goods categories allows the society to avoid "indirect external moral costs" Calabresi argues, that arise from the denial of people's objection to commodification and to the neglecting of the distributional consequences of the pure market allocation. Hence the allocation of merits goods should rest on hybrid mechanisms involving either modified market or modified command schemes if people preferences for merit goods are taken into account. In the case of the rejection of commodification, tort laws provide a prominent example of such hybrid mechanisms for reducing the externalities created by merits goods; these externalities being defined as the "moral cost" people would bear were the merit goods (life and safety) priced directly through the market, Calabresi points out.

Merit goods lie at the heart of law and economics as Calabresi conceived it; first of all because the inclusion of people's preferences about commodification and equality enable regulation policies to be efficient in the sense that third party moral costs are fully integrated, and lastly because the thorough study of the law and the legal institutions should serve to identify merit goods and to elicit people's preferences about merit goods. This renewal of the merit goods' argument confirms the initial statement of Musgrave that merit goods were a category of goods that called for the expansion of the standard economic model.

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