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MERIT GOODS, PATERNALISM AND RESPONSIBILITY

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Introduction

The notion of merit wants was introduced in Musgrave (1956) in the context of his famous description of the three branches of government. Their conceptual place is where the functions of the Service and Distribution branches overlap and their satisfaction is instanced by such programs as free hospitals for the poor or public subsidies for low cost housing, which "may be interpreted as composed of (1) a transfer payment to low income people and (2) a requirement that the proceeds are used to purchase certain services" (p. 341). The theoretical difficulties raised by merit wants are best understood by comparison with public wants which, though not subject to the exclusion principle, are satisfied in line with individual preferences and consumer sovereignty. On the contrary, with subsidies in kind – as is the case in (2) – "public policy aims at interference with individual preferences; and frequently, such interference carries redistributional implications." (*ibid.*) Later, in Musgrave (1959), merit wants are defined in more general terms as wants that are "considered so meritorious that their satisfaction is provided for through the public budget, over and above what is provided for through the market and paid for by private buyers" (1959, p. 13), though the implication is retained that "<t>he satisfaction of merit wants, by its very nature, involves interference with consumer preferences." (*ibid.*)

Since their introduction, merit goods have posed a challenge for public economists, due to their essentially *residual* nature. Our claim could be defended both on epistemological grounds – as argued in Ver Eecke (2003), where the concept of merit goods is judged to be necessary for the completeness of public economics as a theory of governmental activities – and with reference to the identification of merit (or, for that matter, demerit) policies – as suggested in Walsh (1987), where it is argued that "…the merit/demerit policy residual that we wish to identify from the normative viewpoint, after conventional generalised public goods problems have been accounted for, is not an all-inclusive residual. It is, rather, what is left after *both* pure individualism *and* pure paternalism have been accounted for."

(pp. 107–108). The root of the problem is probably to be found in the apparently inextricable connection, in the notion of merit good, of issues related to distortions of individual preferences, redistribution, and public goods alike, as forcefully argued by Head (1966).

Since merit goods imply a more or less intrusive interference with individuals' (revealed) preferences, they have always been accompanied by the suspicion of representing the first step on the slippery slope of paternalism. Welfare economics has traditionally exhibited an anti-paternalistic orientation, on the grounds that in assessing the relative desirability of alternative social options one should respect 'consumer sovereignty' – the principle that is the cornerstone of competitive markets. Recently, however, some prominent economists have advocated a sort of *soft paternalism*, justifying their proposals with reference to the findings of behavioural economics that testify to persistent 'mistakes' in individuals' decision making. Their position has understandably attracted criticism from economists of anti-paternalistic persuasion, which has led in particular to an interesting defence of the principle of consumer sovereignty even in the face of incoherent preferences. In the present paper we intend to review and assess the arguments of both sides, with a special focus on their significance for a clearer understanding of the link between preferences and normative economics.

1. 'Soft' paternalism

In this section we will briefly review the arguments developed by the proponents of soft paternalism, with references to the articles of Sunstein and Thaler (2003a, b) and Camerer et al. (2003).

It is interesting to note, in the first place, in the wake of Camerer and his co-authors, that while historically public authorities exercised their paternalistic tutelage over some categories of *persons* (such as minors, idiots or even married women), the thrust of more recent variants of paternalism is that there are *situations* in which any individual is liable to act in ways that do not promote their welfare. Though this shift of emphasis marks a clear progress towards political equality (and away from gender-based discrimination), we should also be aware that there is in consequence even more need for a precise definition of the circumstances under which paternalistic interventions could be warranted.[1]

[1] It could be added that in some sense legislators have identified new categories of persons particularly in need of protection, as testified by laws and regulations (richly exemplified by both Sunstein and Thaler and Camerer et al.) specifically designed to protect consumers and investors.

Arguing in favour of their proposal of a *libertarian paternalism* Sunstein and Thaler claim that economists' traditional endorsement of an anti-paternalistic stance is based on a false assumption and two misconceptions. The assumption that is deemed to be false (even obviously so) concerns the rationality of individual choices, the presupposition that "almost all people, almost all of the time, make choices that are in their best interest or at the very least are better, by their own lights, than the choices that would be made by third parties." (Sunstein & Thaler (2003b), p. 1163). However, three decades of research by economists and psychologists have accumulated considerable evidence for the existence of bounds on rationality that prevent individuals from acting in their best interests, at least in particular circumstances. Indeed, in the burgeoning literature on behavioural economics one can find several examples illustrating that economic agents are liable to typical errors, especially in intertemporal choice, where they can exhibit dynamic inconsistency or preference reversal, and when facing uncertain outcomes.

The authors do not fail to add some qualifications, conceding that such mistakes are likely to be less frequent when individuals have repeated experience of the objects of choice or can avail of more information (p. 1163), that errors are typically far from universal (and thus do not warrant extended interference in individual preferences) (Camerer et al. (2003), p. 1214), or that learning often enables people to correct themselves (Sunstein & Thaler (2003b), p. 1170). Nonetheless, the suggestion that irrational behaviour is exhibited in the laboratory, but will be less frequent in the real world, especially when the stakes are high, is rejected and thus the possibility is allowed that some of the time people can be helped to make better choices by suitably designed paternalistic policies.

Turning to the first of the two misconceptions allegedly implicit in anti-paternalistic positions, it consists, we are told, in the belief that there are viable alternatives to paternalism. Paternalistic policies are defined as those that "attempt to influence people's behavior even when third-party effects are absent" (Sunstein & Thaler (2003b), p. 1162). Hence, in order to expose the above-mentioned misconception, one has to provide evidence that effects on individual choices are often unavoidable. Both Sunstein and Thaler and Camerer and his co-authors enumerate and exemplify different factors influencing choice in not welfare-promoting ways. Firstly, we have the *status quo bias* attached to default rules or options: for example, participation in retirement saving plans has been shown to be significantly higher under automatic enrolment (with default options for saving rates and asset allocation), which requires employees to opt out, than when they have to opt in by filling in the enrolment form. Secondly, the role of 'anchors', or starting points, in contingent valuation studies is further evidence that individuals have often no well-formed preferences: for example, willingness to pay for specified reductions in the frequency of fatal car accidents has been found to be unduly dependent on the amount of money first displayed to individuals in the study sample. Finally, we could mention the framing effects consequent on the wording of possible options: for example, patients are far more likely to agree to a medical procedure when they are told that there is a 90 per cent chance of survival after five years than when they are told that 10 patients out of 100 die in the first five years. The conclusion to be drawn from the preceding examples is that people's choices are at times influenced by variables that cannot be reasonably assumed to otherwise affect their welfare and that their preferences exhibit variable degrees of instability and context-dependence. On the other hand, it cannot be denied that the presence of default rules is pervasive in the law, even though we are often unaware of their effects. This is the case especially with regard to what Sunstein and Thaler call entitlement-granting rules, providing the background against which individuals act as consumers, workers, investors and so on. Furthermore, important areas of public policy, such as health care or environmental protection, require eliciting preferences from individuals that are often endogenous to the options at issue and markedly influenced by the ways these are presented.[2]

The second misconception that in the view of Sunstein and Thaler contributes to the predominant dogmatic rejection of paternalism is the belief that paternalism cannot but result in coercion. As suggested by the label 'libertarian paternalism' they have chosen for their proposal, the authors are instead convinced that paternalism and freedom of choice are not utterly incompatible. A similar belief is also expressed by Camerer and his co-authors, who argue in favour of 'asymmetric paternalism' or 'regulation for conservatives'. In both cases what is advocated is a milder form of interference with an individual's preferences that preserves as much as possible their freedom of choice. In particular, asymmetrically paternalistic policies should be so designed that they give large benefits to those who are boundedly rational and thus error-prone, while imposing little or no harm on those who are fully rational (Camerer et al. (2003), p. 1212).[3] Both groups of authors provide a list of (potentially allowed) paternalistic interventions, ranking them in increasing order of aggressiveness or heavy-handedness. Sunstein and Thaler distinguish minimal paternalism, required active choices, procedural constraints, and substantive constraints (Sunstein & Thaler (2003b), p. 1188), while Camerer

[2] On the issue of preference formation in relation to environmental legislation, see Sunstein (1993).

[3] Sunstein and Thaler (2003b) emphasize that libertarian paternalism may or may not be asymmetric in the sense just explained (p. 1160, n. 6)

and his co-authors consider default rules, obligations to provide information (or disclosure requirements), cooling-off periods and limitations on consumer choice (Camerer et al. (2003), p. 1224).

The first options in each list more or less coincide, since either of them consists in the selection on the part of the private or public planner of a default option that could provide a welfare-promoting starting point for the boundedly rational agent, while not modifying in any essential way the decision-making process of the fully rational one. Furthermore, default rules come closest to (what we can imagine would be) the pure form of either variant of soft paternalism, since they appear to be *maximally libertarian* paternalistic policies and to encroach the least on the freedom of choice of those individuals who behave in conformity with the presuppositions of rational choice theory. Required active choice – the second policy in the list of Sunstein and Thaler – presupposes the rejection of default options due to the planner's uncertainty about what could be the welfare-promoting option and demands instead that individuals choose explicitly, thus remedying their inertia or the tendency to procrastination. The other two types of paternalistic intervention – procedural and substantive constraints – are designed to sanction, in a more or less severe fashion, individual deviations from default rules, by ensuring that any departure from the default option be entirely voluntary and rational, coming after a close examination of the likely consequences, or by restricting the terms under which deviating is allowed (in both cases the examples offered by the authors are taken from labour and employment law). Cooling-off periods can be viewed as a form of procedural constraint.

A critical difficulty for proponents of soft paternalism is clearly how to select the default rule or plan. In the context of asymmetric paternalism the problem can be neatly formulated as that of finding the optimum of the cost-benefit function that is supposed to underlie the policy design. The function (whose policy-relevant values cannot but be positive) is $pB-(1-p)C-I+\Delta\pi$, where p is the fraction of individuals that are boundedly rational, B is the net benefits to them from a particular paternalistic policy, C is the net costs to rational agents (who comprise, of course, the rest of the population), I are the implementation costs of the policy and $\Delta\pi$ measure the policy expected effects on firms' profits (Camerer et al. (2003), p. 1219). Despite such a clear formulation, the authors do not give concrete suggestions about the likely values of the relevant variables, so for further details we can refer instead to Sunstein and Thaler who devote an entire section of their paper to illustrating the 'toolbox of the libertarian paternalist' (Sunstein & Thaler (2003b), pp. 1190–1195).

The first tool at the planner's disposal is a cost-benefit analysis aimed at measuring 'the full ramifications of any design choice'. We are immediately warned, however, that such an analysis could not be based on individuals' willingness to pay (WTP), since that is generally influenced, as we by now should suspect, by the default rule itself. Therefore, the welfare consequences of different design choices will be inevitably assessed in a somewhat subjective way. Furthermore, the unavailability of relevant information or the disproportionate costs of the analysis would sometimes preclude its viability for policy purposes. Nonetheless, even in such circumstances our planner, we are assured, will not be powerless to decide, for she could rely on a set of 'rules of thumb' that should provide her with that guidance she couldn't get from cost-benefit analysis. As pointed out by Sugden (Sugden (2008), pp. 233), however, it is not at all clear "how one can judge whether a rule of thumb provides a good approximation to the results of a full cost-benefit analysis unless one knows how, in principle, a cost-benefit analysis would work." Specific reservations could also be expressed concerning the single rules of thumb proposed (as recognized by the authors themselves). Actually, the planner could select the approach *i*) that the majority would choose if explicit choices were required and revealed, or *ii*) that minimizes the number of opt-outs.[4] The first *ex-ante* strategy[5] (claimed to be quite familiar in the context of contract law), in trying to mimic the market, is vulnerable to the same difficulties as plague individual behaviour, in that the majority's choices could be as well insufficiently informed, boundedly rational or suffer from self-control problems. The second *ex-post* approach, on the other hand, is based on the unwarranted assumption that there is no asymmetry in the status quo bias, i.e. that "whatever psychological factors induce people to prefer the status quo to alternative options are equally strong whether A or B is the status quo" (*ibid.*)

2. Sugden's opportunity criterion and the agent as a locus of responsibility

A radical (and more general) criticism of the resurgent paternalism briefly delineated in the preceding section has been elaborated by Sugden in a series of

[4] To illustrate, suppose that there are only two options available, A and B, and that when the default option is A x per cent of the persons involved opt for B, while when the default is B y per cent of them prefer the other option. Then, if $x < y$, we should set A as the default option.

[5] *Majoritarian defaults* are also examined by Camerer and his co-authors on the grounds that "in most real-world situations the 'optimal' [default] option is likely to differ across individuals, necessitating a more nuanced approach" (Camerer et al. (2003), p. 1226) They further note that one should anyway take due account of the different costs of errors in setting the default.

related papers (Sugden 2005, 2007, 2008). His major objection is directed to the soft paternalists' conception of the purpose of normative economics. "… soft paternalists […] presuppose a particular conception of what normative economics is about. This conception presupposes a planner with the responsibility to collate information about individuals' preferences and well-being and then, guided by that information, to promote the overall social good. *The soft paternalists' argument is about what such a planner ought to do, given the findings of behavioural economics*." (Sugden (2008), p. 229; italics added) Their approach would share a property that is said to be common to a very wide class of approaches to normative analysis, based on the assumption that "the purpose of normative discourse about society is to assess what is good or right from a single, neutral point of view." (*ibid.*)

The objection, we believe, comprise two different methodological remarks. The first – summarized in the italicized sentence above – focuses on the fact that *normative* judgements are disguised behind the appearance of a merely *positive* analysis building on well-established findings in behavioural economics. We are told that a paternalistic planner is committed to promoting the welfare of individuals by helping them abstain from decisions "they would change if they had complete information, unlimited cognitive abilities, and no lack of self-control" (Sunstein & Thaler (2003b), p. 1162). However, as Sugden aptly points out, "<h>ow, without making normative judgements, do we determine what counts as complete information, unlimited cognition, or complete willpower?" (Sugden (2008), p. 232). Indeed, if applied to an individual's information, cognition and will power the adjectives 'complete' and 'unlimited' can only make sense if we are able to determine – by reference to some normative criterion or other – where to stop in setting the requirements that will enable us to qualify a decision as rational (in the sense of serving best an individual's interests). More information could be gathered, we could improve our cognitive skills and strengthen our will power, so could our decisions ever be qualified as considered, if we did not refer to some normative standard or other?

These reflections point further to a general difficulty in paternalistic approaches which is clearly formulated in the conclusion of the article by Camerer et al. – the need to ascertain "whether patterns of apparently irrational behavior are mistakes or expressions of stable preference" (Camerer et al. (2003), p. 1253). The same point is made by Sugden, when he notes: "…we know that most people tend, other things being equal, to prefer the status quo to change. *This seems to be a fundamental fact about human desire*; *it is not a mistake* that one can correct by becoming better informed, by learning to reason correctly or by acquiring self-control." (Sugden 2008, p. 232; italics added) Another related problem is that of identifying an appropriate welfare standard in the absence of perfect information. The following example taken from Cowen might clarify the issue: "With perfect information and cleansed preferences[6], I would prefer red wine to Coca-Cola, but this hypothetical taste has little bearing on my welfare in a world where my preferences are not cleansed." (Cowen (1993), p. 262) "*The preferences of perfectly informed individuals are not always relevant for imperfectly informed choice.* By considering perfectly informed preferences, we are hypothetically changing an individual's human capital endowment. What an individual would want with a different human capital endowment cannot necessarily be extrapolated usefully into information about what improves the welfare of an individual now." (*ibid.*; italics added)

We can now turn to the second methodological remark implicit in Sugden's objection, concerning the paternalists' conception of normative economics. Soft paternalists err, Sugden argues, in that they constantly evoke the figure of a planner, as is evident also in their claim that there are no viable alternatives to paternalism. Here is how Sugden construes Sunstein and Thaler's anti-paternalistic stance: "Sunstein and Thaler have convinced themselves that paternalism is inevitable by thinking of the anti-paternalist position as a particular kind of recommendation *to a planner*. The anti-paternalist is imagined as someone who recommends a planner to respect individuals' preferences […]. But if those preferences do not exist, some other recommendation is called for. Since (it is presumed) the point of the original recommendation was to promote the customers' well-being, the obvious fall-back is to look for a different criterion of well-being, such as informed desire." (Sugden (2008), pp. 237–238) Sugden's claim is a little speculative (as he himself acknowledges), though suggested by a close examination of the cafeteria example[7] with which Sunstein and Thaler introduce their paternalistic proposal. If he were right, at the root of the erroneous paternalistic conception of the purpose of normative economics there would be an insufficient appreciation of the virtues of the market system and in particular a misunderstanding of the role of entrepreneurship. That's why Sugden, in advocating an alternative rule-based or procedural understanding of normative economics, refers to Hayek's dynamic view of the market as "a spontaneous order structured by the seeking of mutual

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[6] 'Cleansed preferences' are relative to what an individual would want if he or she were fully informed.

[7] See Sunstein & Thaler (2003b), pp. 1164–1166. The authors imagine a cafeteria where customers can serve themselves by choosing among the items displayed in a line along the counter. Then they ask themselves what would be the display strategy of the cafeteria director who had noticed the customers' tendency to choose more of the items that are presented earlier in the line. Four strategies are suggested as the director could display items *at random*, *maliciously* (aiming at customers' maximal obesity), in an *anti-paternalistic* (or *libertarian*) way (giving customers what they would choose on their own), or with a *paternalistic* intent (enabling customers to choose what she thinks would be in their best interests, all things considered).

advantage" (p. 239). Instead, from the perspective of an omniscient planner incoherent preferences are a kind of 'corrupted data', whose integrity should be reconstructed, relying on the scientific findings discovered by behavioural economists.

Besides Hayek Sugden mentions another economist as inspiration for his view of normative economics – the Buchanan who advocates a theory of public finance based on the Wicksellian idea of *voluntary exchange*. Indeed, in another (unpublished) paper (Sugden 2005) relevant for our present discussion Sugden endorses a contractarian approach to normative economics. The key feature of the contractarian approach is deemed to be its view of social value as *subjective* and *distributed*. The second attribute in particular means that "social value […] is not a single measure, expressing a synoptic[8] judgement about what is valuable; it is simply an array of the separate value judgements of the individuals who comprise society. There is, then, no distinction between a person's own standard of value and the standard by which effects on that person are valued." (Sugden (2005), p. 2)

Since we will return to this issue later in the paper, we add here that Sugden highlights that "<a> contractarian theory is addressed to individuals as reflective citizens" and is based on "…an implicit presumption that these citizens are willing to engage in the kind of reasoned argument that the theory exemplifies, and are capable of recognising the validity of what has been shown. Thus, the values that are being promoted should be understood as the considered judgements of the relevant individuals, and not merely as pre-reflective hunches. It seems natural, then, to represent each individual's standard of value as having some degree of internal coherence." (pp. 2–3). Hence, it is perfectly understandable the significance for contractarianism of the notion of 'considered preferences' defined as preferences that "satisfy conventional properties of coherence when defined over a normatively credible universe of objects of choice" and that "are stable under experience and reflection" (p. 5).

Arguing against soft paternalism and its implied conception of normative economics Sugden sets out to explain how one can allow for unstable and context-dependent preferences, while still believing that there is a viable alternative to paternalism and defending a contractarian perspective on socio-economic institutions and public policy. A crucial step in his argument is the demonstration that individuals value opportunities *per se*, even though they can lead to dominated outcomes. As a behavioural and experimental economist Sugden believes that the hypothesis that preferences are often unstable and context-dependent is supported

[8] 'Synoptic' should be related to the 'single, neutral point of view' mentioned in an earlier quotation.

on balance by the accumulated evidence. Thus, he is also aware that any defence of a contractarian perspective on normative economics must reckon with the possibility of incoherent preferences. His argumentative strategy is therefore to provide an alternative account of a simple multi-period decision problem, so designed that an individual with unstable preferences could have an interest to restrict his available choices, to prevent himself from selecting a sequence of actions that leads to an unambiguous loss. To help the reader follow subsequent remarks we briefly outline the three-periods decision problem constructed by Sugden.[9] Imagine an individual named Joe, who in each period can be in one or other of two moods: he is unhappy and risk-loving with probability p ($0 < p < 1$) or happy and risk averse[10] with probability ($1 - p$). In the first period Joe has the opportunity to buy for € 11 a lottery ticket giving a one per cent chance of winning € 1.000. In the second period he can either hold the ticket or sell it for € 9 (which he would be willing to do if in the happy mood). In the third period the lottery is drawn, though for our present purposes it doesn't matter whether Joe will win the prize or not. We can identify therefore three possible outcomes *a*, *b*, and *c*, depending on whether Joe doesn't buy the ticket in period 1, or he buys the ticket in period 1 and then sells it back in period 2, or else he buys the ticket in period 1 and holds it until the lottery is drawn. To complete the description of the decision problem we give the preference orderings over the three outcomes of Joe_L (the unhappy and risk-loving Joe) and Joe_A (the happy and risk averse Joe): Joe_L prefers *c* to *a* and *a* to *b* (having an expected utility of 2, 0, – 1, respectively), while Joe_A prefers *a* to *b* and *b* to *c* (having an expected utility of 0, – 1, – 2, respectively). Finally, we assume that in period 1 Joe is unhappy.

The first thing to note about Joe's decision problem is that there is a sequence of actions – which we label (*buy*, *sell*) – that leads to an unambiguous loss, i.e. outcome *b* where Joe doesn't participate in the lottery and has € 2 less. It would thus seem sensible (for Joe himself as well as for an external observer) to think of restricting the set of choices available to Joe either by eliminating the possibility to sell the lottery ticket in period 2 (*no-resale* version of the problem) or else by preventing Joe from buying it in period 1 (*no-purchase* version of the problem). The second fundamental remark is that conventional decision theory provides no grounds for claiming that the unconstrained decision problem, though possibly leading to a dominated outcome, is the one Joe would prefer to face (this is precisely what Sugden sets out to show). On the contrary, as already suggested, one could be

[9] For further details see Sugden (2007), pp. 666–667.

[10] The assumed correlation between state of minds and attitudes to risk is based on evidence on the role of affect on decision making; for references, see Sugden (2007).

given apparently compelling arguments for imposing some restriction on Joe's choice set. Sequential decision problems like the one at issue, where an agent can have different preferences in different time periods, are usually analysed by assuming the existence of *multiple selves*, one for each different preference of the agent[11] – in our example, Joe would be split into two selves, corresponding to Joe_L and Joe_A. Then, in order to be able to talk about the value the decision problem has for the agent (as opposed to the value it has for one of his multiple selves), one could introduce *metapreferences*, or preferences over preferences. Thus, in our example we could assume that Joe as a continuing agent prefers or identifies with the preferences of one of his selves, even when he is acting on the preferences of the other. In a more general perspective, the agent's welfare could be conceived of as the weighted average of the expected welfare of his component selves.[12] Anyway, whatever approach be chosen for analysing the example given by Sugden, there is no way to demonstrate that Joe could unconditionally favour the unconstrained decision problem to either of the constrained versions. In the words of Sugden, "…viewed from the perspective of a multiple-selves model, the claim that a person can benefit from constraints on his actions in a multi-period decision problem is no more paradoxical than the claim that the two players of a Prisoner's Dilemma can benefit from their both being constrained to play cooperative strategies. But my inclination is to question the appropriateness of the multiple-selves perspective." (Sugden (2007), p. 671)

To overcome the aforementioned difficulties and vindicate the principle of 'consumer sovereignty' even in the face of incoherent preferences, Sugden proposes an alternative conceptualization of the continuing agency of an individual whose preferences may be unstable. Illustrating his idea with reference to the example he has constructed, Sugden claims: "The most natural way to construe the continuing agent—I shall call him Joe*—is as the *composition* of the series of *time-slice agents* 'Joe in period 1', 'Joe in period 2', and so on. By this, I mean that whatever Joe does in any period t is interpreted, not only as the deliberate action of the t-period time-slice, but also as the deliberate action of Joe*." (*ibid.*) An agent is thus conceptualized as a *locus of responsibility*, capable of valuing even the opportunity of acting on unstable preferences, as long as he can view each of his actions as deliberately chosen. Even if the sequence (*buy*, *sell*) leads to an unambiguous loss, the opportunity present in the unconstrained decision problem to do something that he might want to do is valuable for Joe*, since, should that sequence

[11] For a more detailed description see Sugden (2007), pp. 668–671.

[12] Metapreferences are, of course, a special case, since one of the selves is given all the weight.

materialize, that would imply that when he wanted to buy, he bought and when he wanted to sell, he sold.

In order to give a coherent formulation to his fundamental intuition, Sugden introduces the notion of 'nested opportunity sets',[13] defines a principle of 'dominance extension' by which a relation of preference over outcomes induces (iteratively) a relation of dominance among nested opportunity sets and finally proves how decision problems with 'added options' weakly dominate those without them. We will not follow Sugden's elaborate construction further, we note instead that the defence he proposes of a contractarian view of normative economics needs eventually to be based on a normative judgement. As the author himself frankly recognizes, in the iterative construction of the dominance relation among nested opportunity sets "…we must make a transition from 'unambiguously, *S* gives at least as much opportunity as *T*'[14] to 'unambiguously, *S* is at least as preferable as *T*'. That is, *we must assert that more opportunity is unambiguously preferable to less. That is a substantive normative claim, which not everyone will accept.* I can only say that it is fundamental to my approach: Dominance Extension expresses a commitment to the normative value of opportunity." (Sugden (2007), p. 677; italics added)

To fully appreciate Sugden's conclusions we have to put the single fragments together and reconsider his peculiar endorsement of contractarianism. In Sugden (2005, 2007) it has been rather convincingly argued that individuals can value being free to act on their own preferences, *considered or unconsidered*, as and when they experience them. In addition, Sugden (2004) had investigated how markets react to incoherent preferences over well-defined consumer goods traded under competitive conditions, had defined an 'opportunity criterion' which is deemed to be the analogue in the domain of opportunities of the Pareto criterion in the domain of preferences satisfaction, and had proved that competitive markets are quite effective in providing that kind of freedom we have earlier referred to as incorporating the value of opportunities for agents (the latter result is the analogue for an opportunity-based efficiency standard of the first fundamental theorem of welfare economics). This valuable property of markets simply presupposes "the privileging of the preferences of the *acting self*—the self as buyer, seller and consumer, rather than the self as the maker of plans or as the source of reflective judgements about the well-being of the continuing person. Or, more accurately, the market privileges the preferences of acting *selves*." (Sugden (2008), p. 243) Finally, in Sugden (2008) all these conceptual tools are deployed to contest the arguments of

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[13] A generalization of the familiar notion of an opportunity set to encompass multi-period decision problems.

[14] *S* and *T* are possibly nested opportunity sets.

soft paternalists and to argue, in particular, that there is a viable alternative to paternalism – the market (p. 247). As concerns contractarianism, even in the face of the findings of behavioural economics testifying to the instability and context-dependence of preferences, it can be preserved and founded on "an alternative standard of value, based on considered judgements about opportunity rather than on considered preferences" (Sugden (2005), p. 3). The vindication of both the market and contractarianism, therefore, requires us to identify an agent with his or her acting selves. As a simple corollary, it is claimed that "…when making judgements about one's continuing interests, one has to treat the preferences of each of one's acting selves as authoritative with respect to the decisions that fall to that self—rather than trying to form a single coherent system of preferences and treating any deviation from those preferences by one's acting selves as mistakes, as weaknesses of will, or as the product of external manipulations of one's 'true' self." (Sugden (2008), p. 243)

Conclusion

Preferences are an essential ingredient of economic theorizing, in particular when normative issues are under scrutiny. Preferences, however, as has long been recognized, have an uncertain (or, better, twofold) nature. On the one hand, they may be conceived as being "substantively exogenous characteristics of individuals" (Hamlin (2007), p. 3), defined independently of their choices. As a consequence, the path from preferences to choice would require separate analysis, also allowing for other motivators of choice apart from preferences. On the other hand, revealed preferences refer directly to choice, so that a preference ordering is intended merely to 'rationalize' an individual's choice behaviour, however that may be motivated.[15] So conceived "preferences are an analytic convenience rather than characteristics of the individual. To use preferences in this sense as the basis for welfare would be to elevate choice itself to normative significance." (*ibid.*)

Soft paternalism has the major drawback that on its premises more public interventions could be recommended than are really warranted. It is often not at all clear that individuals as reflective agents would prefer to diet rather than indulge or save more rather than spend so much. On the other hand, we cannot either conceal

[15] A similar distinction between *psychological preferences* and *revealed preferences* (or choice behaviour) is introduced in Mandler (2005), where it is argued that completeness and transitivity cannot be rationalized under either definition of preference, though each property can be separately justified using one of the definitions.

our perplexity at some of the anti-paternalistic claims. Certainly, we have no difficulty in acknowledging that contractarianism as a normative theory can in a sense cope well even with incoherent preferences. We believe, nonetheless, that *endogenous preferences* pose a more serious challenge to normative economics – a challenge that needs to be taken up. *Autonomy*, or responsibility as Sugden would claim, is certainly of paramount importance, also as providing a non-consequentialist (or, at least, not directly consequentialist) explanation of the virtues of the market. However, how long can we ignore the question of preference formation? How long individual choice behaviour can be examined focusing on preferences and essentially overlooking the perhaps equally important *belief* component? As noted above, Sugden himself remarks that contractarianism is addressed to individuals as *reflective* citizens, who are willing to engage in the kind of normative discourse that the theory exemplifies; he thus implicitly recognizes the significance of the cognitive dimension in normative analysis. In addition, we believe it is worth exploring an interesting suggestion by Camerer and his co-authors, who after acknowledging that "people may have an intrinsic taste for free choice" add: "<w>e feel that how people perceive limits on their free choice should itself be subject to behavioral research, rather than be treated as an axiom of resistance in the exploration of paternalism." (Camerer et al. (2003), p. 1214, n. 11)

Anyway, while arguing for the need of a deeper analysis of the links between preferences and choice and for an extension of the economic model of individual behaviour that takes due account of its cognitive dimension, in the absence of more secure foundations for policies inspired by soft paternalism, we believe that public choice concerns should be given proper weight. As Müller and Tietzel (2002) warn, a normative justification of merit policies from an individualistic perspective requires, firstly, that evidence be given of the need for interfering in individual preferences by reference to some 'defect' in individual decision-making and, secondly, that the envisaged public intervention be the most appropriate means to remedy that particular defect. On closer inspection, it is likely there will be often room for doubts on both counts for most so-called merit (or paternalistic) policies.[16]

[16] Camerer et al. (2003) are aware of the risks of abuse by politicians and bureaucrats, allowing for the possibility that asymmetrically paternalistic policies be poorly designed and badly implemented, which would be reflected in the implementation costs *I* in their cost-benefit function (p. 1219, n. 27). A similar awareness, though much more nuanced, is present also in Sunstein and Thaler (2003b), p. 1200, n. 145.

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