

HUL360: Selected Topics in Philosophy

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Reading packet I

Selections from ‘Economic Analysis, Moral Philosophy, and Public Policy’

- 1 How is Moral Philosophy relevant to Economics?
- 4 How Could Ethics Matter to Economics?
- 11 A Shocking Memorandum
- 27 Is Unemployment Involuntary?

seriously. If there really is nothing right or wrong in moral matters, then there is nothing wrong with intolerance.

There is nothing dogmatic or intolerant about believing that some answers to moral questions are better than others and that rational argument can help one to judge which answers are better. These beliefs are implicit in our everyday individual moral judgments and in our policy making, and it is hard to deny them without denying that there is any such thing as morality.

1.3 How Is Moral Philosophy Relevant to Economics?

The idea that studying ethics could help people to do economics or policy analysis may seem far-fetched. Why not consult Tarot cards instead? Many people – indeed, probably some of you reading these very words – doubt that moral philosophy can help one do *anything* better (except perhaps to spread confusion and cure insomnia). If one is seeking clarity, why look in a swamp?

Our hope is that readers of this book will not leave with the impression that argument in moral philosophy is obscure, unworldly, or boring. It is, to be sure, intellectually demanding, abstract, and often intricate; like economics itself, moral theory is loaded with controversies and unresolved issues. We want most of all to show that moral reasoning can help people gain a surer grip on serious problems about how to make their lives and our society better.

But even if moral philosophy clarifies morality, why should it clarify economics? Many economists would draw a sharp distinction between evaluative questions and the “positive” science of economics, which is concerned with facts, not values. In the 1930s, Lionel Robbins expressed this view as follows: “It does not seem logically possible to associate the two studies [ethics and economics] in any form but mere juxtaposition. Economics deals with ascertainable facts; ethics with valuations and obligations” (1935, pp. 148–9). Robbins is drawing on a commonsense distinction (which is maddeningly difficult to make precise) between factual claims and evaluative claims. Intuitively, there is a huge difference between describing how many tons of steel the United States imported in 1999 and saying whether importing foreign steel is a good or a bad thing.

Although there is, we believe, no way to draw the distinction between facts and values precisely, it is worth describing how some influential philosophers and economists have distinguished them. [Table 1.1](#) summarizes the contrasts. We should stress that these contrasts are highly controversial

Table 1.1. *Exaggerated contrasts between facts and values*

Factual claims	Evaluative claims
Disagreements can be resolved by evidence	No good way to resolve disagreements
Relatively little disagreement	Relatively little agreement
Descriptive: say how things are	Prescriptive: say how things ought to be
True or false	Not true or false
Objective	Subjective
Independent of evaluative claims	Dependent on factual claims
Bear on action, only given motives	Guide action: logically tied to motives

and that (as we shall argue in the [Appendix](#)) the distinctions are exaggerated and in some cases mistaken.

Drawing these contrasts in this overly sharp way makes it easy to see why economists have thought it was so important to argue that economics is and should be “value neutral”: that it makes and should make no evaluative claims. Many economists believe that only factual claims can be studied by the methods of science, and their status as scientists is important to their self-understanding and to their social prestige. In this view, economists trespass beyond the boundaries of science and of their proper social role when they take stands concerning evaluative matters.

This view of the separation between scientific claims, which are the subject matter of economics, and evaluative claims, which cannot be the subject matter of any science, might be expressed as follows: “Economics is science or engineering. It shows how to arrive at certain goals but, unlike ethics, it does not prescribe what goals one should have. Economics provides technical knowledge that has no more to do with ethics than does geometry or physics. No matter how sensible and well-conceived ethical theories may be, they have nothing to do with economics and cannot possibly help one understand economics.”

This entire book is a response to the view that ethics and economics have (and should have) nothing to do with each other. The best case for relating economics and ethics is to show that linking the two subjects is productive in the practice of those disciplines. We begin to make this case in [Chapters 2](#) and [3](#) by showing through examples how unproductive it is to try to “cleanse” economics of the evaluative content of familiar economic ideas such as efficiency, welfare, and freedom. Instead of beginning this book with abstract philosophical considerations concerning the relations between economics and ethics, we have postponed that discussion

to an [Appendix](#) in which we directly challenge the claim that economics and ethics should be sharply separated. There we also criticize explicitly the “engineering” vision that portrays economics as entirely value neutral. In the main text of this book we try to be constructive, showing concretely how evaluative and factual matters are entangled in economics and policy analysis.

1.4 Organization of the Book

[Chapters 2](#) and [3](#) present four examples that illustrate ways in which moral questions arise in economics, and [Chapter 15](#) returns to these examples and applies the concepts, distinctions, and principles developed in the intervening chapters. [Chapter 16](#) reflects upon some of the new challenges that recent economic transformations and their consequences pose for mankind and shows how the analyses of this book help to clarify them. The chapters in between – [Chapters 4](#) through [14](#) – are divided into four parts.

[Part I](#) focuses on rationality, morality, and markets. Like morality, rationality is normative. One ought to be moral and one ought to be rational. One is wicked if not moral and foolish if not rational. Rationality, unlike morality, plays an explicit and conspicuous role in contemporary economic theory. Economists usually deny that economic theory presupposes any ethical views, but they freely admit that it presupposes a great deal about rationality. However, economists cannot have it both ways. Endorsing their theory of rationality, we will argue, already commits them to controversial moral principles. In defending their model of rationality, economists wind up espousing fragments of a moral theory.

It also turns out, we shall argue, that exploring the connections between morality and rationality leads to criticisms of economics, because the moral principles implicit in standard views of economic rationality are implausible. When these principles are stated explicitly, few people would endorse them. The standard views of rationality held by economists also make it hard to understand the rationality of norms and of morality itself. Without an appreciation of the importance of morality and the constraints it imposes on self-interest, it is hard to understand the limits that all societies impose on the extent of the market.

[Parts II](#) and [III](#) then zero in on concepts and theories of economic evaluation. Which economic policies and institutions are best? How should they be judged? [Part II](#) focuses on the standard theory of welfare and on methods of evaluating economic outcomes and institutions in terms of their consequences for welfare, such as welfare economics and utilitarianism. We

APPENDIX

How Could Ethics Matter to Economics?

We hope in this book to have shown how knowing moral philosophy can help one to do economics better and how economics can contribute to ethics. The most persuasive way to make this case is the one we pursued in the main text: by describing important aspects of moral philosophy and showing their bearing on economics. Many economists are nevertheless inclined to deny that moral philosophy has anything to contribute to economics. Why? In this Appendix, we explore some of the arguments and reaffirm the central thesis of this book – that ethics is relevant to economic inquiry.

We shall assume that those economists who would deny that moral philosophy is relevant to economics distinguish positive economics, which addresses factual questions, from normative economics, which addresses evaluative questions, and that they recognize that moral philosophy is relevant to normative economics. But they deny that moral philosophy is relevant to positive economics. We respond to three key arguments in support of their position. [Section A.1](#) considers the role of positive economics in policy making and argues that normative questions are almost always implicated in such work. The [second section](#) turns to the general question of what it means to say that positive economics is “value free” and then sketches what we call “the standard view” of the relation between positive and normative economics. [Section A.3](#) comments briefly on the exaggerated distinctions sometimes drawn between positive and normative inquiries, criticizing in particular the view that evaluative claims cannot be rationally addressed. The [fourth section](#) revisits the standard view and discusses some problems it faces. Having argued that economic work presupposes ethical commitments, that normative inquiries are subject to reasons, and that the standard view is overly strong, we return to the question of whether positive economists have anything to learn from studying ethics.

A.1 Objection 1: Economists as Engineers

There are economists who deny that ethics is relevant to economics and go on to repudiate normative economics as the bastard offspring of completely distinct inquiries that ought to be completely separate. And yet they do not deny that economics is relevant to policy making. It is relevant – vitally relevant, they agree – but in their view only in the way that civil engineering is. Owing to a need for electric power, policy makers might consider building a dam. Civil engineering does not say whether this is a worthy objective. Engineers instead provide information about how difficult it is to build dams in different locations, how much electricity the dams can generate, how much land they will flood, and so forth. Engineers thereby provide answers to some of the “What if...?” questions that policy makers need to answer when they are deciding whether or where to build a dam. In order to accomplish anything, people need knowledge of cause and effect, and engineering can provide such knowledge. The first objection to the view that ethics is relevant to economics thus asserts that the role of economics is exclusively to provide causal information. Ethics helps determine the ends that policy makers pursue, and it constrains the means they may employ. Positive economics clarifies the consequences of alternative policies. Both economics and ethics are crucial to policy making, but neither has anything to do with the other.

The following very simple schema might help clarify this view.

1. Our policy ought to achieve goal G and satisfy constraints $C_1, \dots, C_n$.
2. X satisfies $C_1, \dots, C_n$ and achieves G .
3. Thus our policy should be to do X .

Premise 1 comes from ethics or political philosophy while premise 2 comes from positive economics and other relevant bodies of empirical knowledge. The conclusion is a moral judgment, which follows loosely from both the moral premise 1 and the technical premise 2. On the view of economists as engineers, premises 1 and 2 have nothing to do with each other, and ethics has nothing to contribute to economics.

This schema is too simple. After all, X may have other desirable or undesirable features, and there may be better alternatives to X . To incorporate these considerations, one might suggest the following schema:

1. Economic policy should be governed by the complete moral or social ranking R .
2. The consequences of X rank higher in R than do the consequences of any other policy under serious consideration.
3. Thus economic policy should be to do X .

The moral premise in this schema says a great deal more than the moral premise in the first schema. It evaluates all the consequences of the various alternative policies. For example, in the case of a proposed law prohibiting arbitrary firings, *R* would specify the moral importance of at least the following: the benefits and harms of prohibiting arbitrary firings, the harms from the intimidation of workers on the job, the harms of unemployment among the lowest strata of workers, the benefits or harms to overall productivity, and so forth. The economist's job is then to determine what are the consequences of the alternative policies with respect to these morally relevant aspects. Once all the consequences are known, the policies can be ranked. Economists are seldom able to tell policy makers exactly what the consequences of policies will be, but they may instead be able to determine the probabilities of different outcomes. This information will then make it possible to rank policies via weighting the moral values of their outcomes by the probabilities that they will obtain. As in the simpler schema, the policy conclusion depends on both moral and technical premises that are independent of one another.

The second schema, unlike the first, is not too simple. Its drawback is that it is too demanding. No existing moral system is refined enough to provide the needed first premise, and economics is not up to the challenge of providing the second. Real policy making relies instead on partial moral rankings of salient features of policies and their consequences. The moral considerations policy members invoke are influenced by positive information concerning what sort of consequences the policies under consideration have, while the positive study of their consequences is channeled by normative views of what kinds of consequences matter. The view of economists as pure engineers cannot be sustained.

We recognize that this view does fit some economic theorizing – for example, work devoted to estimating how much revenue would result from changing income-tax rates. But, even here, economists often need to understand (even if they do not share) the values to which policy makers are committed in order to understand what policy makers want to know and what questions to ask.

Furthermore, applying the second schema to the activities economists undertake is often impossible; the political process rarely formulates its economic problems clearly. Fritz Machlup (1969) points out that when economists are called on to give “purely technical” advice about how to accomplish certain ends, they are rarely given purely technical problems. Consider the tasks of economists who are asked to guide the Greek government in managing its debt and restoring economic growth. Without knowledge of the political history, the prevailing values, and the moral and

political constraints on policies, they will not know how to proceed. What range of possibilities should they consider? What options are off the table? It is likely (though not inevitable) that the values to which economists are committed – including their best judgment about what will be good for the Greek people, whose government they are advising – will influence what alternatives they consider and what weights they place on the comparative advantages and costs. Even if, in principle, the Greek government could specify all the relevant objectives, constraints, and evaluative considerations, in practice economists will have to rely on a general grasp of ethics to fill in the gaps. Economists need to understand the moral values that shape the set of options to be considered.

Evaluative commitments are also bound to be crucial to the choice of problems to investigate and often of the tools of investigation as well (Weber 1919). This is not a criticism of that research: there is no sensible alternative – all research must proceed from an evaluation of what it is important to know. It is certainly important that economists be aware of the moral commitments that structure their own research projects, if for no other reason than avoiding bias. These moral commitments may lead them to overlook some feasible alternatives or to overstress the significance of others. Mistakes about how best to respond to economic challenges such as the collapse of the U.S. housing market can diminish the lives of tens of millions. It does not take much moral knowledge to know that widespread financial panics are “important,” but it does take some. In deciding what to study and in thinking about how to apply economics to practical problems, economists must think about ethical matters. They need not do so systematically or self-consciously, or well, but they cannot avoid ethics altogether.

We suspect that engineers often have the same need to invoke values to clarify problems and objectives that economists have. In designing a super-highway, the civil engineer is unlikely to have available a social ranking of all the various combinations of aesthetic appeal, safety, durability, expense, ease of traffic flow, and so on, that combine to make a good highway. Which alternatives then should he consider? Which possible permutations of these parameters need not be presented? Why? It is an oft-noted fact that much professional practice involves wrestling with situations in which the normative and the positive are deeply entangled.

A.2 Objection 2: Positive Economics Is Value Free: The Standard View

Economists cannot avoid an entanglement with ethics if they want to understand the terms of policy debate, to help determine public policies, or

to select problems for study. But many economists would insist that the role of ethics ends there: ethics can pose or shape the economist's questions, but it cannot contribute to her answers. The second objection to the view that understanding ethics contributes to doing economics maintains that there is a positive economic science and that this science is "value free." Let us call this position *the standard view*. Some further clarification is in order, as follows. (For an insightful alternative interpretation see Mongin 2006.)

As mentioned in [Chapter 1](#), most people can readily distinguish questions concerning empirical facts – what is – from questions concerning what ought or ought not to be the case. This is the so-called fact–value distinction. It is difficult to make this distinction precise. For example, in stating, "That was a kind thing to do," is one describing a fact or morally appraising an action? And some philosophers argue that the fact–value distinction breaks down altogether. But let us suppose that it is possible roughly to classify questions as either factual or evaluative.

The standard view maintains that ethics is concerned with questions of value, while the sciences are concerned with questions of fact. Moreover, the standard view maintains that questions of fact and of value are in two ways independent: (1) although facts may contribute to answering evaluative questions, they cannot settle them, and (2) values have no role whatsoever in answering factual questions. In both ways, there is an inferential gap between facts and values. On the standard view, positive economics can be value free, and, moreover, it should be value free.

To speak of a value-free inquiry may be misleading, because it suggests that the *conduct* of the inquiry is value free. But the conduct of inquiry cannot possibly be value free. Inquiring involves action, and action is driven by values. As we have already seen, values influence choices of what to study. Values also influence choices of what methods to employ and consequently of what hypotheses to discard or to pursue. It is because of their moral commitment to the goals of science that economists resist "cooking" their data. It is because of their personal morality that economists do not shoot those who disagree with them. The standard view does not deny that values influence the conduct of inquiry. What is meant by a value-free inquiry is instead (a) an inquiry into a question of fact or a question of logic in which (b) the answers are not influenced by any values except those that are part of scientific activity itself.

The standard view recognizes that the results of positive inquiries can be relevant to policy, because those results can show that specific policies facilitate or frustrate the attainment of valued goals. But without some prior evaluative commitment, the findings of positive science settle no questions of policy or value. Thus the study of ideology and of the values of

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Bear on action, only given motives	Guide action: Logically tied to motives

economists is irrelevant to understanding economics or economic methodology, though it may help one to understand the scientific failings or motivations of particular individuals. We will present some criticisms of the standard view after considering aspects of it more deeply.

A.3 Objection 3: Normative Questions Are Not Subject to Rational Evaluation

The standard view draws a sharp distinction between factual claims and evaluative claims. Thus, for example, Milton Friedman maintains with respect to disagreements about fundamental values that “men can ultimately only fight” (1953, p. 5). Reprinted for the reader’s convenience are the exaggerated distinctions of Table 1.1.

Sharply distinguishing between facts and values and between positive and normative science does not commit one to these distinctions. For example, the independence of facts and values does not imply that evaluative claims are merely subjective. The possibility of distinguishing between positive and normative economics does not imply the standard view that they should be pursued separately (Weston 1994).

At issue in this Appendix is whether positive economics is completely value free, not whether rational arguments concerning values are possible, but even so, we do want to cast doubt on the distinctions listed above. The main point we insist on has, we hope, already been demonstrated in the chapters of this book. It is that *normative questions* – questions concerning evaluative claims – *are subject to rational discussion and resolution*. Consider, for example, our discussion of a preference satisfaction theory of well-being, the adequacy of utilitarianism, or the plausibility of the goal of welfare equality.

One usually addresses such questions with rational arguments rather than experiments (which are, in any case, only rarely possible even in positive economics). Now it is true that rational argument is not sufficient to resolve all disagreements about value. Nevertheless, moral principles can be assessed by examining their implications, and specific judgments can be criticized on the bases of their factual presuppositions and the moral principles upon which they rely.

The other contrast we want to contest is that between, on the one hand, the objectivity of factual claims and, on the other hand, the alleged subjectivity and arbitrariness of evaluative claims. Whether evaluative statements can be literally true or false is a difficult question that we will not attempt to answer. Prescriptions cannot be literally true or false, but not all evaluative claims are prescriptions (consider again the statement “that was a kind thing to do”). What is crucial, in our view, is that not all answers to evaluative or specifically ethical questions are equally good. Some are way off the mark, some rely on unreasonable assumptions, while there is good reason to regard others as in some relevant sense correct. If by “objective” one means that claims are correct or incorrect regardless of whether people believe that they are correct, then – as our discussion shows – many evaluative claims are objective. Whether a market in pollutants would be beneficial is not determined by whether people think it would be; slavery’s wrongness does not rest on popular opinion. The bottom line is that recognizing that there is an important difference between facts and values and between normative and positive inquiries does not require one to denigrate normative inquiry or to insist that the inquiries be isolated from one another.

A.4 Answering the Standard View: How Knowing Ethics Contributes to Positive Economics

Thus far, we have examined some problematic exaggerations of the standard view but we have not criticized it directly. Before taking up this task, it is important to recognize how large a role for values the standard view potentially allows. It is compatible with the recognition that economists may need to understand the concepts and criteria that guide evaluation of economic outcomes and processes, and it can grant that ethics has an important part to play in economic life. Its proponents can even concede that it may sometimes be difficult to be a good economist without knowing some ethics. All the standard view maintains is that positive economics, considered as a body of knowledge, is wholly independent of ethics. We can therefore endorse the standard view without abandoning our project of showing

TWO

Ethics in Welfare Economics

This book will be filled with arguments, but we shall begin with examples to bring them down to earth. One good example may do more to clarify how ethics matters to economics than would a hundred pages of argument. Furthermore, ethical reasoning is not just a matter of logic. Emotion has its part to play, too, and examples help to engage the emotions. In this chapter and the next, our concern is not to *argue* that ethics matters in economics but to *exhibit* through examples how important ethics is.

In this chapter we will focus on two examples, which will enable us to identify the main moral assumptions that characterize mainstream *normative economics*. The first example caused an uproar.

2.1 A Shocking Memorandum

Consider the following confidential World Bank memorandum, which was published in *The Economist* (February 8, 1992, p. 62). Larry Summers, then the World Bank's chief economist, absorbed the criticism the memorandum provoked, but he was probably not the author:

Just between you and me, shouldn't the World Bank be encouraging *more* migration of the dirty industries to the LDC's [less developed countries]? I can think of three reasons:

- (1) The measurement of the costs of health-impairing pollution depends on the foregone earnings from increased morbidity and mortality. From this point of view a given amount of health-impairing pollution should be done in the country with the lowest cost, which will be the country with the lowest wages. I think the economic logic behind dumping a load of toxic waste in the lowest-wage country is impeccable and we should face up to that.
- (2) The costs of pollution are likely to be non-linear as the initial increments of pollution probably have very low cost. I've always thought that under-populated

countries in Africa are vastly *under* polluted; their air quality is probably vastly inefficiently low [*sic*] compared to Los Angeles or Mexico City. Only the lamentable facts that so much pollution is generated by non-tradable industries (transport, electrical generation) and that the unit transport costs of solid waste are so high prevent world-welfare-enhancing trade in air pollution and waste.

- (3) The demand for a clean environment for aesthetic and health reasons is likely to have very high income-elasticity. The concern over an agent that causes a one-in-a-million change in the odds of prostate cancer is obviously going to be much higher in a country where people survive to get prostate cancer than in a country where under-5 mortality is 200 per thousand. Also, much of the concern over industrial atmospheric discharge is about visibility-impairing particulates. These discharges may have very little direct health impact. Clearly trade in goods that embody aesthetic pollution concerns could be welfare-enhancing. While production is mobile the consumption of pretty air is a non-tradable.

The problem with the arguments against all of these proposals for more pollution in LDCs (intrinsic rights to certain goods, moral reasons, social concerns, lack of adequate markets, etc.) could be turned around and used more or less effectively against every Bank proposal for liberalisation. (quoted in the *Economist*, February 8, 1992, p. 66).

The memorandum is worth reading carefully, and we urge you to read it a second time before proceeding further. It is a provocative exploration of the implications of “economic logic” rather than a serious proposal for a World Bank program to export pollution to the LDCs. What makes this memorandum particularly worth studying is that its economic logic appears to be exemplary, yet its conclusions are alarming to many people.

2.2 Eight Distinctive Features of Welfare Economics

The World Bank memorandum does not purport to be just a study of facts, which bear on policy only in the way that engineering bears on policy. On the contrary, this note makes claims about what the World Bank “should” be doing, and it describes some facts as “lamentable.” The memorandum clearly makes evaluative claims, and it would be excluded from economics by those who insist that economics must be free of any value judgments. Yet this memorandum obviously seems to be concerned with economics. One way to recognize this, while still insisting on the importance of distinguishing between factual and evaluative claims, is to maintain that there are two kinds of economics: “positive economics,” which deals only with matters of fact, and “normative economics,” which is concerned with the evaluation of economic states of affairs, processes, and institutions. This memorandum is clearly an instance of normative economics.

We would like to draw your attention to eight features of this note, which are, we maintain, typical of mainstream normative economics or “welfare economics.” Each of these features represents a choice: its way of thinking about economic states of affairs and policies is just one of *many* possible ways available to us. Once one recognizes what distinguishes this way of thinking about outcomes and policies from other ways, one understands a great deal about this kind of normative economics.

1. We have already mentioned the first of these eight features: the memorandum *evaluates* economic states of affairs and *recommends* how to improve them. The focus is on economic outcomes rather than processes.
2. The memorandum assumes that there is a single framework for economic evaluation, which it takes for granted. It does not state this framework explicitly or argue for it. Though the author probably would not state the matter this way, he relies on an ethical foundation that he believes his readers share.
3. The memorandum takes the form of an *argument* in which premises concerning costs and demand are supposed to establish conclusions concerning what the World Bank should do and what facts are lamentable. That argument seems to draw on rather intricate economic and ethical *reasoning*. The ethical conclusions are not based on appeals to emotion or prejudice.
4. The memorandum considers how policies and states of affairs bear on *individuals*. No questions are asked about the significance of their other effects, such as those on the environment or local cultures, except insofar as those in turn affect the welfare of individuals. The note assumes that what matters consists entirely in the consequences of the policy for individuals.
5. The memorandum evaluates economic states of affairs in terms of their consequences for individual *welfare* rather than with respect to any other feature of individuals. It is concerned about whether transfers of pollution would be “welfare-enhancing.” Owing to the prevalence of this feature, mainstream normative economics is typically called “welfare economics.”
6. In measuring welfare, the memorandum implicitly accepts the way that markets evaluate states of affairs, when (competitive) markets exist.
7. Although the memorandum focuses exclusively on welfare, it does not attempt to add up welfare gains and losses or to compare the welfare

of different people. It does not claim that trade in pollution would maximize total or average welfare. Indeed, total or average welfare is never mentioned.

8. In addition to focusing exclusively on the welfare implications of shifting pollution, the memorandum suggests that there is a qualitative difference between the “impeccable” “economic *logic* of dumping a load of toxic waste in the lowest-wage country” [our emphasis] and miscellaneous and unspecified ethical objections in terms of “intrinsic rights to certain goods, moral reasons, social concern, lack of adequate markets, etc.” The implication is that the welfare arguments are rigorous and worth taking seriously, while the miscellaneous ethical objections can be disregarded. (Otherwise, the claim that these objections “could be turned around and used more or less effectively against every Bank proposal for liberalisation” should lead him to criticize the World Bank’s proposals for liberalization rather than to make an additional one!) Welfare economists rarely deny explicitly that other moral considerations are relevant to evaluating policies and outcomes – and indeed this memo makes no such argument. Welfare economists are, however, often suspicious of, impatient about, or even contemptuous of other ethical concerns.

Some of these eight features of welfare economics are widely shared in the thought and culture of modern liberal democracies, while others are more distinctive to mainstream economics. Thus the presumption that social policies are subject to rational evaluation through argument, as in items 1 and 3, is widespread (though hardly universal), while the tendency to focus on outcome evaluation and downplay process is more peculiar to economics. Similarly, “individualism” – in the particular sense of item 4, that the only sources of ultimate value are human individuals – is a familiar feature of liberal social theory, while the idea that only the *welfare* of those individuals ultimately counts (item 5) is more specific to normative economics.

These features of welfare economics, even those that are widely shared with liberal social theory more generally, are not inevitable. Each involves a choice, and each feature could be questioned or changed. These choices are both methodological and ethical. Although welfare is obviously very important, so is freedom and so is equality, and normative economics might focus on them in addition to or instead of welfare. *There are alternatives*, and to choose among them requires ethical reflection.

One of our tasks, which will occupy much of [Parts I and II](#) of this book, is to lay bare the philosophical principles underlying welfare economics and

then examine to what extent these principles constrain the character of normative economics. Another task, which will occupy [Part III](#), is to consider alternative approaches. Rather than passing judgment, we aim to reveal the philosophical complexities implicit in policy evaluation and the range of choices that economists might reasonably make.

2.3 The Economic Benefits of Exporting Pollution to LDCs

The last three of the eight features of the memorandum we highlighted are all concerned with the economic benefits of transferring pollution to less developed countries. In [Part II](#) we shall have a good deal to say about the notion of an economic benefit or cost, but a few words here will help clarify the argument in the memorandum. Air and water pollution lessen the quality of life in many ways, yet most kinds of pollution have no market prices. One cannot go to the hardware store and purchase for \$19.95 a 20 percent decrease in the toxic chemicals in the air one breathes.

Three factors explain why there are few markets in pollution limitation. First, it is not possible to locate all the sources of air and water pollution. (If your neighbors decide to dump left-over weed killer down their drain, who will ever know?) Second, even if it were possible, it would be prohibitively expensive to strike a deal with all the polluters in order to improve your air or water. Third, any deal you strike with polluters will affect your neighbor, and vice versa: while walking to the corner, you have to breathe the same air your neighbor breathes. Any effective deal will require cooperation among your neighbors. Thus some collective action is often needed to deal with pollution.

One way economists can help with the problems of controlling pollution is by *imputing* costs to it. The goal is to figure out what pollution costs would be, if there were markets where pollution could be bought and sold. Economists may attempt to impute pollution costs by examining housing prices in communities that are much the same, apart from their air quality. They can draw inferences from how much people pay for air filters, water filters, or bottled water. They can collaborate with biologists in determining and assessing the costs of damage to health caused by pollutants. In such ways, economists may be able to estimate how much people in developed countries would be willing to pay to lessen pollution in their environment and how much people in LDCs would have to be compensated in order to be willing to accept more pollution.

People may be ignorant of the harms caused by pollution. People in a LDC may be willing to accept toxic wastes for very little compensation,

because they are unaware of the contents of the wastes, the harms they might do, or the prospects of the wastes escaping and poisoning groundwater. Any willingness to accept more pollution that is based on such mistakes does not truly reflect what serves a person's interests. The memorandum avoids this difficulty, because it argues that the willingness of those in LDCs to accept pollution for less compensation than those in developed countries are willing to pay rests on differences in the consequences of pollution in LDCs and developed countries.

Economists employ complicated techniques to determine economic costs when things are not literally bought or sold, and it will simplify the discussion here if we engage in some make-believe. Suppose pollution could be bought and sold on the market. Since pollution is a "bad," consumers would want to buy its *absence*. Let us think of reductions of pollution that consumers could buy as units of a single hypothetical commodity, "environmental quality." We can then think about what the price of units of environmental quality would be in this make-believe world in which individuals could separately purchase and consume environmental quality while firms could separately produce and market units of it.

One can then take the memorandum to be arguing that – were it possible for individuals easily to buy, sell, and transport "environmental quality" – there would be active trading between the developed and less developed nations of the world, and pollution would be pouring out of the developed nations and into the less developed nations. Wealthy people would be buyers of environmental quality and poor people would be sellers for the same reasons that wealthy people are buyers of house cleaning services and poor people are sellers of them. But units of environmental quality cannot ("lamentably"?) be individually appropriated, bought, and sold, and it is hard to transport pollution between nations. Consequently, the World Bank can enhance welfare by simulating what a hypothetical market would accomplish and facilitating transfers of polluting industries to LDC's.

2.4 The Argument of the World Bank Memorandum

The three points in the memorandum aim to show that the amount individuals in developed countries would be willing to pay to lessen their pollution is more than the amount that individuals in LDC's would demand in order to accept more pollution; also, there would be more pollution in LDCs if pollution were easily exchangeable. But why should one conclude that it is "lamentable" that pollution is not easily exchangeable? Why should one conclude, "Clearly trade in goods that embody aesthetic pollution concerns could be *welfare-enhancing* [our emphasis]?" What makes it an

improvement to approximate more closely how things would be if pollution could be easily traded? How is one supposed to reach the conclusion that “the World Bank [should] be encouraging *more* migration of the dirty industries to the LDC’s”? How does one get from claims about hypothetical markets or willingness to pay to claims about welfare and from claims about welfare to claims about what the World Bank *ought to do*? We need to clarify the logic implicit in the memo.

We suggest that the argument can be spelled out as follows:

1. Rational agents in LDCs would accept pollution from developed countries for less compensation than rational agents in developed countries would be willing to pay to get rid of the pollution. In other words, for some compensation C – that lies between the least that agents in LDCs will accept and the most that agents in rich countries will offer – all rational individuals, whether in developed countries or in LDCs, would prefer to transfer pollution from a developed country to a LDC (premise 1).
2. Whatever individuals prefer makes them better off or increases their welfare (premise 2).
3. Shifting pollution to LDCs from developed countries and paying some compensation C makes everyone better off (from 1 and 2).
4. One should adopt policies that make people better off (premise 3).
5. One should adopt policies that shift pollution to LDCs and pay compensation C (from 3 and 4).

If one assumes that the jobs and revenues provided by dirty industries are “reasonable compensation,” then this reconstruction captures what is meant by the claim that “the World Bank [should] be encouraging *more* migration of the dirty industries to the LDC’s.” In fact, as the memorandum notes, many transfers of pollution are not feasible, and individual units of pollution typically cannot be bought or sold. Some economists might argue that it would be a good thing to shift pollution to LDCs regardless of whether there is any compensation – on the grounds that there is a “net benefit” in such shifts. But it takes more controversial moral premises to establish this stronger conclusion, and we will not comment on arguments that rely on the notion of a net benefit until [Chapter 9](#).

Statements 2 and 4 appear to be moral premises, and in later chapters we shall examine them at length. Premise 2 is particularly important in forging the link between market evaluation and welfare by identifying welfare with the satisfaction of preferences. This feature lies at the very core of mainstream normative economics. It is through that identification (plus the connection that positive economics establishes between preferences

Table 2.1. *The moral framework of normative economics*

-
-
1. What should economists appraise?
 - a. *Outcomes*
 - b. Processes
 2. What method(s) of appraisal should economists use?
 - a. *Single method of appraisal*
 - b. Multiple ethical perspectives, depending on problem
 3. What matters about outcomes?
 - a. *Consequences for individuals*
 - b. Consequences for groups, or the environment
 4. Which features of outcomes for individuals matter?
 - a. *Welfare*
 - b. Freedom
 - c. Rights
 - d. Justice
 5. What is welfare?
 - a. *The satisfaction of preferences*
 - b. Some mental state, such as happiness
 - c. "Objective" goods – e.g., achievements, personal relations, health
 6. How does welfare (as preference satisfaction) bear on the evaluation of outcomes?
 - a. *Market evaluation and the Pareto concepts*
 - b. Add up preference satisfaction
 7. What role do other ethical notions play?
 - a. *Independent; important, but not a concern of economics*
 - b. Their importance is derivable from their consequences for welfare
 - c. Must be integrated into the economic appraisal
 - d. Of no importance
-

Note: Responses in *italics* are those of orthodox welfare economists

and market prices) that the memorandum links premises about costs and demands to conclusions about what outcomes are good or bad and what policies will enhance welfare.

We especially want to emphasize that the tone of the memorandum (which is addressed to fellow economists, not to the public at large) is misleading. It suggests that the three numbered paragraphs make a "scientific" case, while the last paragraph mentions wishy-washy moral objections. But the moral content does not wait for the last paragraph to make its appearance. The three numbered points of the memorandum above are already part of a *moral* argument.

Table 2.1 lists some of the alternatives normative economists face and the specific choices orthodox welfare economists have made.

2.5 Should the World Bank Encourage Migration of Dirty Industries to LDCs?

The uproar caused by this memo suggests that many people are not willing to accept its conclusion. This may be a thoughtless first reaction. Why should not the World Bank encourage migration of dirty industries? Since the argument appears to be logically valid, those who reject the conclusion have to reject at least one of its premises. Though we cannot speak for all those who find the conclusion objectionable, here are five possible objections. (We will consider others in [Chapter 15](#).)

1. Premises 1 and 3 tacitly assume that the consequences of pollution are local and that the amount of pollution is independent of where the pollution takes place. Both these assumptions are questionable. Encouraging dirty industries to migrate to LDCs might lead to more total pollution. Developed countries have both the incentive and the administrative capacity to enforce pollution controls, while LDCs have weaker incentives to limit pollution, and they may have a harder time enforcing pollution regulations. Since many of the consequences of pollution are global, the consequences of encouraging the migration of dirty industries to LDCs may be very bad.

Although the first objection – that migration of dirty industries will increase worldwide pollution – is a serious one, it need not challenge the memorandum’s moral framework, and we shall have little to say about it. To the extent that the effects of pollution are not localized, the arguments concerning the benefits of shifting pollution are not valid. If the harms of pollution are not mainly local, then one cannot conclude that the migration of dirty industries will be beneficial – no matter how attractive they may be to the particular traders.

2. Even if people in both developed economies and LDCs would be happy to shift pollution to LDCs for some reasonable compensation, the exchange is *unfair*. Consider an agreement between a billionaire and a beggar whereby the beggar agrees to work sixteen-hour days in exchange for gruel and a straw mattress. Both parties may be rational and well informed, and enter the agreement “voluntarily.” (As we will see in the [Chapter 3](#), the idea that any exchange not directly involving physical force is voluntary is a controversial moral claim.) The fact that an exchange may be voluntary does not by itself justify it. For example, many might object that the billionaire is exploiting the beggar.

This analogy may understate the injustice of transferring pollutants in LDCs, because some of the poverty in LDCs has been caused by the developed countries. For example, agricultural subsidies in rich nations have devastated agriculture in poor countries. Exploitation seems more egregious if the wealthy party caused the other's poverty.

This second objection would not surprise the author of the memorandum, who alludes to such objections in the last paragraph, but offers no response apart from the rather alarming observation that such objections "could be turned around and used more or less effectively against every Bank proposal for liberalisation." This unfairness objection shows that premise 4, that policy should make people better off, needs qualification. It is plausible to maintain that, *other things being equal*, it is a good thing to make people better off. But other things are not always equal. It may not be good to make people better off if doing so is unfair.

To point out that shifting pollution to LDCs may be exploitative does not show that it is wrong. Most people are prepared to put up with some injustice in exchange for a sufficiently large increase in welfare. Before deciding what is best, one needs to know how large the welfare benefits will be and how much unfairness will result. But normative economics only talks about welfare; it has nothing to say about how to think about trade-offs between justice and welfare. One misleading feature of this memo is its suggestion that, apart from some moral bellyaching, the policy implications are simple.

3. The memorandum's analysis compares only one alternative to the status quo: that of shifting pollution to LDCs. What about other policies that might be better still? Notice that the case for transferring pollutants depends on the huge income disparities between rich and poor countries: without those disparities why would people in, say, Africa pay less to avoid pollution than people pay in the United States? Should this status quo income disparity be simply taken as given? A much more effective policy for enhancing welfare might be to transfer income rather than pollution from rich to poor countries.
4. Satisfying preferences does not automatically increase welfare. People may prefer things that wind up being bad for them. They might do this because they lack information about the costs and benefits of different options, because they are choosing between options all of which have negative consequences for them, or because they have adapted their preferences to fit their circumstances. Voluntary exchange need not always be mutually advantageous.

The basic point in this objection is hard to deny, but economists can argue that, given the actual consequences of increased pollution in LDCs, rational individuals in LDCs *should be* willing to accept pollution for less money than individuals in developed nations should be willing to pay. The reasons are that wages are lower in LDCs, low levels of pollution do little harm there, and poverty in LDCs makes clean air and water relatively less important. The greater willingness to accept pollution does not derive from miscalculating the effects of pollutants. The standard reasons why one might question whether satisfying people's preferences would make them better off do not apply.

5. What about premise 1, that all rational and well-informed agents would prefer to make the exchange? This premise is itself the conclusion of an argument from the fact that the economic costs of pollution are lower in LDCs than in developed countries. But do the economic costs and benefits capture what is morally relevant? Must rational and well-informed individuals accept the market's evaluation of the consequences of the pollution? Is premise 1 not a controversial moral premise, too?

The moral relevance of market prices is questionable, even when they do not reflect any ignorance or irrationality. Individuals need not accept the market's evaluation of the consequences of the pollution. If there were markets on which all varieties of environmental quality could be bought and sold, there would be massive transfers of pollution to LDCs. But those transfers would not necessarily increase human well-being. Let us see why.

People in LDCs are willing to pay relatively less to avoid pollution, because pollution causes relatively less harm in LDCs. It causes relatively less harm (as indexed by willingness to pay) because wages and productivity are lower, because people are more likely to die of other causes before they can be harmed by pollution, and because there are other pressing needs on which individuals will spend their money first. But is willingness to pay the right way to measure economic benefits? Are economic costs and benefits a good guide to what is harmful and beneficial? Given the current unequal distribution of wealth, people in rich countries will pay much more to prevent crippling injuries than people in poor countries will. But the moral significance of crippling injuries arguably should not depend on whether the victim lives in a wealthy country. A middle-income person in a rich country might pay five hundred dollars to add a larger flat-screen TV to her den, while a poor person in an LDC might decline to – or be unable to – pay the local equivalent of five hundred dollars to fix his broken leg. Willingness to

pay is a dubious guide to what *ought* to be done. To regard costs and prices, as determined by actual markets, as markers of *moral* significance is a dubious moral presumption. For a telling example, consider the following:

Market Value vs. Moral Value

In some cases market value seems to differ drastically from what most people would regard as moral value. The drug eflornithine is a highly effective “miracle” cure for sleeping sickness, which infects tens of thousands of people in Southern Africa. Until 1999 eflornithine was produced by a U.S. subsidiary of the Aventis company, but when eflornithine proved ineffective against cancer (its intended target), Aventis stopped making the drug, which is expensive to synthesize, and gave the production license to the World Health Organization. People who contract sleeping sickness are very poor, and there was no money in producing a cure for the disease. Only in early 2001, when stocks of the drug were almost exhausted, was the WHO able to find drug companies to manufacture it – and then only because the companies hoped to make profits from marketing eflornithine in developed countries as a cream that removes facial hair. It is currently sold under the brand name Vaniqa. By market criteria, eflornithine is of value because it removes facial hair, but as a cure for sleeping sickness it is not worth producing.

In fact, economists do not typically identify the value of a human life with the loss of expected earnings or with the differing amounts different people would pay to prevent a death. But why not? If economic costs and benefits are a good guide to what is harmful and beneficial, then they should be a good guide to the allocation of risks of death and injury; and if they are not a good guide to the allocation of risks of death and injury, why should one believe that they provide an acceptable way to measure benefits or harms?

The World Bank memorandum is an amalgam of economic analysis and moral philosophy. Or perhaps it would be less misleading to say that its economic analysis already contains ethical assumptions. We do not pretend to have proven that ethics is mixed up in all of economics and cannot be separated out; indeed, in the [Appendix](#) we shall consider proposals for isolating a pure “value-free” science of economics. Our point here is illustrative. Economics of the kind exemplified by the World Bank memorandum is shot through with controversial ethical premises. [Table 2.1](#) illustrates this point by listing a number of questions that must be faced by anyone

concerned with the evaluation of policies and by presenting some of the alternatives to the answers mainstream economists have generally given.

2.6 School Vouchers

Our second example involves a controversy concerning primary and secondary education: the proper role of competition and market incentives in the provision of schooling.

Economists distinguish between the case for public *funding* of some product or service and the case for direct public *provision* of that item by government workers (Schultze, 1977). The argument for public funding is usually cast in terms of some public purpose in expanding production and consumption of the service above what the market will provide. What mechanism should be used to accomplish this purpose is a separate question, and economists often argue that markets have advantages in terms of efficiency and freedom compared to direct provision. Even though markets often possess these admirable features, it may not always be best to rely on them, both because markets sometimes fail (as in the case of pollution) and because, even when they succeed, markets might undermine other values. However, economists are on the whole inclined to believe that markets are neutral with respect to other values and to take market failures as the only justification for government interference. Economists typically regard the market as serving given preferences – as a means to furthering people's ends, whatever they may be. This is a substantial moral assumption, which is more reasonable in some circumstances than others, as the case of public elementary and secondary education illustrates. Can it be right to rely on preferences to evaluate a practice such as schooling, which so strongly shapes preferences?

The question of public provision versus public funding has arisen in a particularly sharp way in the context of elementary and secondary schooling in the United States. More than a half-century ago, Milton Friedman (1962, ch. 6) argued that the social interest in ensuring that all young people receive an education does not imply that the government should operate schools. He proposed that government funding for schooling should be provided instead in the form of vouchers. Vouchers are certificates that families can use to purchase schooling and that schools then redeem for cash.

There are many possible variants on a voucher system. Vouchers could be a fixed amount per student, or they could vary with family income or the differing costs of educating students with special needs. Some voucher proposals would permit parents to supplement the value of the voucher, while others

the effects of dismantling publicly provided education on social solidarity and on the existence of a common culture. Classrooms are already often segregated by class, race, and religion, and voucher systems have the potential to exaggerate that segregation. Although many parents want their children to get to know children from different backgrounds, other parents would prefer that their children associate only with others of the “right” class, religion, or race. Overt discrimination by schools can be prohibited, but self-selection is difficult to control, and the possibility that vouchers will help to bring about a future in which children grow up wearing the blinders of narrow communities is not far-fetched. Such a system might be splendidly efficient, and possibly even fair, while at the same time causing the dissolution of community or the undermining of national identity. Society does not consist solely of market exchange within political constraints, and markets are not morally neutral apart from their contributions to freedom and efficiency. Awareness of the ways in which markets compete with other institutions and of their bearings on values such as justice, solidarity, and community can help economists contribute more thoughtfully to debates about schooling. We take up these issues in more detail in [Chapter 6](#) when we discuss the question of whether or not the market has moral limits and whether everything should be treated as a market good.

2.7 Conclusions

Our purposes in discussing the World Bank memorandum and school vouchers are, to repeat, only illustrative. Our goal is not to pronounce on whether school vouchers are a good idea or on whether pollution ought to be exported from wealthy countries to LDCs, and it is certainly not our intention to maintain that welfare economics is misguided. Indeed, it is the unabashed clear-headedness of the applications of familiar economic ideas that makes the examples powerful. The point of the examples is to show that mainstream normative economics rests on substantial and controversial moral premises and to make our claim plausible: that knowing ethics can contribute to doing economics.

Suggestions for Further Reading

General overviews of the relations between economics and ethics can be found in Allen Buchanan (1985), Hamlin (1986), Sen (1987a), and Gaus (2007).

There has not been much scholarly discussion of the World Bank memorandum, although it raises general issues concerning cost–benefit analysis, which have been extensively discussed; see [Chapter 9](#). For an excellent discussion of the notion of exploitation, see Wertheimer (1996). Satz (2010) also uses the memorandum as an example of the need to enrich the evaluative basis of economics.

The classic statement of the case for vouchers as a mechanism for the public finance of education appears in Milton Friedman (1962, ch. 6). For a very different statement of the case for vouchers, see Gintis (1995). An influential empirical study is John Chubb and Terry Moe (1990). Criticisms of vouchers from the standpoint of democratic theory are advanced in Amy Gutmann (1987 and 2000) and from the standpoint of justice in Harry Brighouse (2000). A comprehensive treatment of charter schools can be accessed at www.publicagenda.org/media/charter-schools-in-perspective-pdf (2014).

Questions for Study and Discussion

1. What do you think of the three arguments in the World Bank memorandum for exporting pollution to poor countries?
2. As summarized in [Table 2.1](#), this chapter points out that there are alternatives to the many aspects of the ethical framework deployed in the World Bank memorandum and that welfare economics rests on choices concerning what to appraise and how to appraise it. Consider how welfare economics would change if just one of the many choices were made differently.
3. The argument in [Section 2.4](#) is logically valid. That means that if you accept all of the premises, you must, on pain of inconsistency, accept the conclusion. If you do not accept the conclusion, then you need to deny at least one of the premises. What do you think of the premises of that argument?
4. An argument very much like the one in the World Bank memorandum can be made for eliminating some of the limits many societies place on markets, such as laws prohibiting prostitution, the consumption of recreational drugs, the buying and selling of organs for transplant, or the buying and selling of rearing rights to newborns. In each case, economists can argue that allowing these transactions will make both parties to the transaction better off. Try to construct a rigorous argument for this conclusion analogous to the argument in [Section 2.4](#).

If you do not accept the conclusion, which of the premises would you criticize?

5. Which of the many choices that constitute standard welfare economics seems to you especially defensible or especially indefensible?
6. Which of the objections in [Section 2.5](#) to exporting pollution to less developed countries seems to you the strongest? Which seems the weakest?
7. One might argue that the actual effects of globalization have not been all that different from what the World Bank memorandum espouses. Lots of polluting industries have moved to LDCs, and they have brought a good deal of economic development with them. Is it so obvious that the conclusions drawn in the World Bank memorandum are repugnant?
8. What is your view of changing from state-provided public education to a voucher system?
9. How, if at all, has the discussion of vouchers in this chapter changed your views concerning their advantages and disadvantages?
10. The results of voucher systems depend heavily on details of their design. In the light of the issues raised in this chapter, how would you design a voucher system?
11. The results of state-provided education systems also depend on details of their design. What are the leading improvements you would recommend for the system of state-provided education that now exists in the country you live in?
12. As this chapter emphasizes, economists evaluate policies mainly in terms of *efficiency*. On the basis of the case studies in this chapter, what would you say are the main advantages and disadvantages of assessing policies mainly in terms of their efficiency?

THREE

Ethics in Positive Economics: Two Examples

Although some economists have envisioned the possibility of a value-neutral normative economics that merely investigates the consequences of policies for the satisfaction of preferences, most would be willing to concede that moral judgments do play a role in normative economics. For that reason, they might also concede that when evaluating policies economists should pay attention to matters of ethics. But when it comes to *positive* economics – the attempt to predict and explain economic outcomes and processes – few economists see any role for ethics.

Although it is possible (even in economics) to investigate features of the world without evaluating them, it is often hard to do so. When matters of economics bear strongly and immediately on people's interests, those interests and the moral considerations that are relevant to them are likely to influence the questions economists ask and the answers they defend. Because of this, it is important to understand the values that are at stake.

Familiarity with moral philosophy can help here. Although values will be most obvious in debates over practical policy questions – consider debates over energy policy, prescription drug benefits, agricultural policy, or tax policy – moral considerations can have a much broader influence. We shall show this influence in two examples. Both concern matters of fact about economies that bear on policy questions. The first example, which concerns whether there is any involuntary unemployment, is likely to seem odd to readers who are not familiar with economics. How, one might ask, could anybody doubt that some people are unable to get a job? We shall shortly see. Whether workers are unemployed voluntarily or involuntarily seems to bear on the question of what sort of unemployment compensation they should be paid, but its normative implications and presuppositions go deeper. The second example, which involves Paul Samuelson's overlapping generations model, might appear to have no bearing on policy; but as we

shall argue, its normative implications have in fact driven what is purported to be a purely theoretical debate in positive economics.

3.1 Is Unemployment Involuntary?

“Macroeconomics” – which treats the institutions and processes governing the economy as a whole – was born during the worldwide economic depression of the 1930s with the publication of John Maynard Keynes’s *General Theory of Employment, Interest, and Money*. Among the central goals of macroeconomics have been explaining and figuring out how to remedy involuntary unemployment. During the last few decades, influential economists have argued that this inquiry rests on a mistake, because there is in reality no such thing as involuntary unemployment, except perhaps as a brief transitory occurrence.

In everyday language, a person is “voluntarily” unemployed if she quits her job and chooses not to accept another one. A person is involuntarily unemployed if she loses her job and is unsuccessful in finding another one. People who are voluntarily unemployed are “at leisure”: they choose not to be employed because they prefer some other set of activities to working under current labor-market conditions. Indeed, in the way economic statistics are kept, many of those who are not working are not counted as unemployed at all – to be considered unemployed you must be actively looking for work. How you define who counts as unemployed has significant consequences, especially in countries where only the officially unemployed can qualify for benefits under social insurance programs.

The disputes between those who seek to explain involuntary unemployment and those who deny that there is any involve matters of economic theory and methodology. Yet the moral interpretation of the idea of “voluntariness” is significant as well, as we argue in more detail in this section. Whether economists deny that there is involuntary unemployment is linked to their views on policy. Most Keynesian economists, who believe involuntary unemployment is an important phenomenon, are also inclined to believe that activist monetary and fiscal policies are essential in managing modern economies. Thus, Shapiro and Stiglitz write, “To us, involuntary unemployment is a real and important phenomenon with grave social consequences that needs to be explained and understood” (1985, p. 1217).

Those who are skeptical of involuntary unemployment tend to believe, in contrast, that individual activities coordinated by markets work out well and that government action is more likely to cause than to cure economic difficulties. Thus Robert Lucas suggests that unemployment is like any other economic choice:

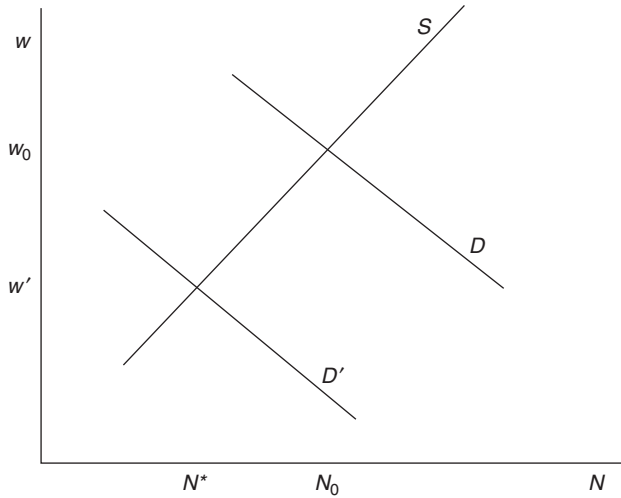


Figure 3.1. Supply and demand in the labor market.

The unemployed worker at any time can always find some job at once, and a firm can always fill a vacancy instantaneously. That neither typically does so by choice is not difficult to understand given the quality of the jobs and the employees which are easiest to find. Thus there is an involuntary element in all unemployment, in the sense that no one chooses bad luck over good; there is also a voluntary element in all unemployment, in the sense that however miserable one's current work options, one can always choose to accept them. (1978, p. 354)

Lucas emphasizes the voluntary aspect: "By treating all unemployment as voluntary, this work has led to the examination of alternative arrangements which firms and employees might choose to adopt for dealing with fluctuations in product demand" (p. 356).

The analytical and methodological issues raised by this dispute are complicated, and we can only sketch them here. The logic of standard micro-economic theory states that if demand for some product or service drops, producing an excess supply of it, then the price will promptly drop until the excess supply is eliminated. So, viewing labor as such a service, there should be no excess supply of labor or unemployment. Keynesian analyses claim that the self-correcting mechanisms that smoothly adjust for fluctuations in supply and demand in commodity markets fail in the market for labor in the economy as a whole.

Simplifying drastically, one might depict the market for labor in a given industry as in [Figure 3.1](#). The supply curve, S , shows how much labor workers are willing to supply at each wage. We are oversimplifying and equating this with how many workers want to work. The demand curves D and

D' show how much labor (how many workers) firms want to employ at each wage. The demand curves slope downward, because firms are willing to hire more workers when wages are lower. The supply curve slopes upward because workers are willing to work more at higher wages. Here D shows the demand for labor before the shocks that gave rise to the Great Depression, such as the Wall Street stock market crash of 1929. At the “equilibrium” wage w_0 , the number of workers whom firms want to employ and the number of workers who want to work both equal N_0 , and there is neither unemployment nor excess demand. There is then a shock that lowers demand to D' . Though there will (in reality) be confusion and transitory unemployment, the theory abstracts from this and shows that equilibrium will be restored, though at a lower wage of w' and a lessened employment N' . Fewer workers are employed, but none are unemployed. Everyone who wants work at the new wage w' can find work.

Keynes argued that in the transition from an individual market to the system as a whole – from micro- to macroeconomics – this story of how markets equate supply and demand breaks down. Unlike in an individual market, a drop in the wages of labor across the economy lowers workers' purchasing power. With lower wages and fewer workers employed, the population will not be able to purchase as many goods and services, reducing aggregate demand. Exactly where and how the analogue of the micro-economic argument breaks down and whether there exist any mechanisms within the market system that will correct the imbalance in aggregate supply and demand are questions that have shaped the evolution of macro-economic theory for three-quarters of a century. But, at least in Keynes's view, unemployment cannot be attributed to the unwillingness of workers to accept lower wages, and it falls to government to provide the proper cure, which is to stimulate higher aggregate demand via monetary or fiscal policy.

It is difficult to incorporate involuntary unemployment into a coherent choice-theoretical account of the economy (DeVroey 2004). As a simple illustration of this challenge, suppose one redraws the supply curve to represent the reluctance of workers to accept employment at wages below w_0 (see Figure 3.2). This has been proposed as one way of characterizing the assumption of “rigid” or “sticky” wages, which on some interpretations is a key assumption of Keynesian economics. The unwillingness of workers to accept employment at wages below w_0 is depicted by drawing the supply curve as horizontal to the left of the old labor market equilibrium (at w_0 and N_0). Because workers refuse to accept jobs for wages less than w_0 , employment drops all the way to N^* , where the supply curve intersects the new demand curve. Orthodox theorists do not believe that a supply curve such

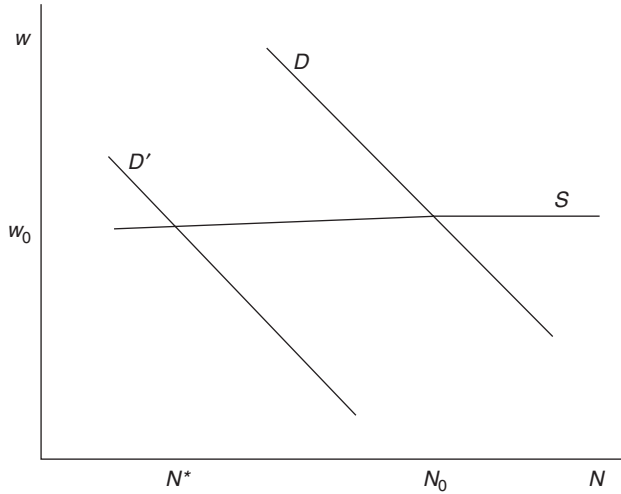


Figure 3.2. Sticky wages.

as the one shown would continue to reflect workers' preferences, believing rather that workers' expectations that they would find work at w_0 would collapse.

Although some theorists attempted to explain involuntary unemployment by means of a horizontal supply curve, it seems instead (as De Vroey argues) that, along the horizontal segment of S , workers must be indifferent between working and not working. They prefer not working to accepting jobs at wages below w_0 , and they prefer accepting jobs at wages above w_0 to not working. The intersection of D' and S is a point of market equilibrium, and at w_0 , workers do not prefer to supply more or less labor than N^* . Suppose, for example, that $w_0 = \$8.00$ per hour. What the diagram says is that any individual worker willing to work for $\$7.99$ per hour can readily find a job. The decisions of such workers to decline an offer of a penny less per hour would appear to be voluntary. Since workers are doing what they prefer to do and since nothing prevents them from accepting lower wages, [Figure 3.2](#) does not depict a situation involving involuntary unemployment. (This pertains to the labor force as a whole. At a more detailed level, it is possible that some workers coercively prevent others from accepting jobs at lower wages.)

Indeed, it is arguable that in [Figure 3.2](#) there is no unemployment at all – at least as unemployment is conventionally measured. It is not the case that the $N_0 - N^*$ workers who were employed before the shift in demand and who are not now employed would strictly prefer working at the going wage

to not working. Since they do not prefer working to not working at w_0 , they have no reason to seek work at w_0 and thus, on one plausible construal of what it means to be unemployed, they are not literally unemployed at all! They are instead (perhaps unhappily) at leisure. Moreover, within the framework of economic theory, the situation depicted in Figure 3.2 is “efficient.” Workers and firms are behaving in accordance with their preferences. Nothing in the graph captures the fact that something has gone wrong; the enormous human cost of the Great Depression has simply disappeared. The attempt to comprehend involuntary unemployment by means of Figure 3.2 is neither plausible in itself, because workers’ expectations will adjust, nor adequate to the theoretical problem, because workers are not indifferent between working and remaining unemployed.

In order for there to be involuntary unemployment, it must be the case that workers would strictly prefer to be working at the market wage but are unable to find a job – or, in other words, that the jobs and wages available to those who have lost their jobs are substantially worse than those of workers with similar qualifications who are still employed. This means that actual employment at the market wage must be off the supply curve. In Figure 3.1, for example, the wage must somehow get “stuck” above w , even though there are workers who are willing to work for less.

But what prevents the wage from falling? Except as a bit of transitory confusion, from which economic analysis abstracts, when demand shifts as it does in Figure 3.1 wages must fall unless (as in Figure 3.2) workers are indifferent between working and not working at the old wage w_0 . Simply to assert that wages are “sticky” does not explain why. Apart from totalitarian control over labor, how is it possible to be off the labor supply curve? However “obvious” it may be that a good deal of unemployment is involuntary, when one steps into the theoretical world of economics and focuses on graphs like the two shown here, it is hard to understand how involuntary unemployment is possible.

This is the point that Lucas and other members of the “rational expectations” school focus on. Their view – which is shared by many economists of other schools, too – is that an adequate analysis of economic activity must be built up from proper “microfoundations.” Theorists must assume that every actor is acting rationally on the basis of the information available to him and that every actor invests rationally in acquiring information. Unemployment results from rational search. In searching for a new job, an unemployed worker is viewed as continually weighing the quality of the best option she has found against the likelihood of finding a better option by searching longer. Periods of high unemployment occur when more people

are searching and the average search is longer. Lucas hastens to counter any “blaming the victim” accusation that might follow such a claim: “treating unemployment as a voluntary response to an unwelcome situation does not commit oneself to normative nonsense like blaming depressions on lazy workers” (1978, p. 356).

Whether some version of the rational expectations program can ultimately succeed in reducing macroeconomics to microeconomics is a hotly disputed question. But even if a worker’s unemployment can be shown to be rational from her point of view, does that make it “voluntary”? Both Keynesians and “rational expectations” theorists agree that, in depressions, the alternatives facing workers become sharply worse from the worker’s own perspective. And both agree that the project of explaining in detail how labor markets work in these circumstances is a difficult problem, not fully resolved. In his denial that he is blaming the victim, Lucas shows his awareness that the word “voluntary” carries significant normative freight: if unemployment is voluntary, then it is the worker’s own responsibility and of lesser social concern. Similarly, in speaking of the “grave social consequences” of involuntary unemployment, Shapiro and Stiglitz ally themselves with a critical and activist social agenda. In our view, a better understanding of ethical theory has a good deal to contribute here.

Both in everyday and in philosophical discourse, whether a choice is voluntary depends both on the quality of the alternatives and on the circumstances bringing about the occasion for choice. The choice posed by the robber who offers “your money or your life” is involuntary in the sense that the alternative to parting with one’s purse is *unacceptable* because the choice is brought about in an illegitimate way: the robber does not have a right to your purse, but you do. The fact that handing over one’s money to the robber is a rational choice – and that it comes about through the agent’s own actions and intentions – does not make it voluntary in the relevant moral sense. People can be subordinated to others even though they still have choices. Robert Solow captures this understanding of voluntariness as follows:

You can take the definition that is actually there in the General Theory, and loosen it up so that it says that someone is involuntarily unemployed if he or she would be prepared to work at a job that he or she knows how to do, at the going wage, and cannot find employment. That is good enough for me. You will notice that by this definition a person can be involuntar[il]y unemployed and employed at the same time. If you take an inferior job you can still be an involuntar[il]y unemployed skilled worker. (Snowdon and Vane 1999, p. 287)

Solow here denies that all rational choices are voluntary. To claim that people are involuntarily unemployed is not to claim that they cannot find any job at all. Unemployment should be considered involuntary when people do not have any job opportunities that are reasonably good by the standards of their society. What if the available jobs do not pay enough to support a minimally decent life? Or what if the only jobs available to the unemployed that pay well are illegal or carry stigma, such as smuggling or prostitution? Since whether the alternatives to unemployment are “reasonably good” is clearly a normative question – and not just for the workers – the economist’s concept of involuntary unemployment is itself, in part, a normative concept. (The normative criterion in Solow’s definition is that a “reasonably good” alternative for one who is unemployed is a job–wage package that others with the same qualifications are actually enjoying.)

Those who claim that – even in a depression – all unemployment is voluntary might then be understood in one of three ways. The first way is that they have made a mistake that could have been prevented by a greater familiarity with ethics: they are confusing “voluntary” with “rational.” From the perspective of unemployed workers, the available jobs, such as selling apples or shining shoes for a wage that cannot sustain them or their families, are not acceptable; their refusal to accept these jobs is not voluntary. In the same way that it can be rational for Ann to give her purse to a robber, that does not mean that her choice to do so was not objectionably constrained. Even a slave makes choices. But no one would deny that her servitude was involuntary.

A second possibility is that the dispute between Keynesians, on the one hand, and Lucas and others on the other is fundamentally normative: they disagree about whether the alternatives to continuing to search are reasonably good, at least as temporary expedients. While Keynesians might look at working at extremely low-wage jobs as unacceptable alternatives that should give rise to positive government action, those inclined to *laissez faire* might value the choice to accept such jobs as falling within a sphere of individual freedom.

The third possibility – closely related to the second alternative – is that those who regard unemployment as voluntary understand spells of unemployment, even occasionally severe and widespread spells, as part of the normal workings of a market economy and (viewed perhaps in a lifetime perspective) understand that having to endure such spells is a reasonably good alternative to arrangements that would eliminate the risk of unemployment. To the extent that unemployed workers in effect have faced a hypothetical choice between secure jobs with no stretches of unemployment and

less secure jobs that are otherwise more attractive, they have had reasonably good alternatives and may be deemed to be unemployed voluntarily.

The key point to note in this debate is that voluntariness is at root a moral notion, closely related to judgments of freedom and personal responsibility. If unemployment is involuntary, then it threatens economic freedom as well as wasting resources and lowering welfare. Emphasizing that workers are not responsible for their fate invites a search for governmental remedies. Robert Skidelsky's (1992) biography of Keynes describes the importance Keynes attached to these emphases as he developed his arguments through the 1930s. If economists regard unemployment as voluntary – a matter of searching longer rather than accepting an available job – then it is easier for them to see it as part of the normal workings of a market economy, as relatively unthreatening to basic social values, and as less obviously a government's responsibility to fix. On this view, if workers did not have unreasonably high expectations, then unemployment would disappear.

The roots of these contrasting ethical perspectives lie in differences in attitudes toward market outcomes and processes as well as government intervention, which align plausibly (though not necessarily) with differences in theoretical view. Thus Keynes himself and Keynesian followers are inclined to see widespread unemployment as revealing a basic flaw in both market economies and microeconomic theory, and they have argued that a different theory is needed for the economy as a whole than for its parts. On the other hand, those who see unemployment as voluntary generally believe that market economies perform well without government interference and that macroeconomic theory can be built on axioms depicting every individual as choosing optimally under conditions of rational expectations. These disagreements led to heated controversies concerning how to respond to the severe economic downturn beginning in 2008, with Keynesians arguing for more government stimulus, and the descendants of rational expectations theorists arguing for government austerity to restore business confidence and lessen market distortions.

The links we have noted between judgments about the voluntariness of unemployment, about the adequacy of microeconomic equilibrium theory to explain macroeconomic phenomena, and about the role government should play in reducing unemployment are not logically tight. One can believe that unemployment is both involuntary and the source of grave social consequences yet still think there is nothing government can or should do about it. In contrast, one can believe that unemployment is involuntary (in the moral sense just defined) and still think that a suitably developed theory of rational expectations equilibrium is the best approach

to explaining it. Still, the links among these views are not entirely coincidental, and the energy that goes into defending alternative positive theories of unemployment derives in large part from the normative views that frequently accompany particular theoretical positions. Though disagreements would obviously remain, a better understanding of ethics (in particular, of the nature of voluntary choice) would help to refine them.

3.2 Overlapping Generations

In his celebrated paper “An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money” (1958), Paul Samuelson addresses the following problem: suppose individuals want to save for their old age, when they cannot produce anything, and suppose nothing lasts from one period to the next. All people can do if they do not want to starve is to strike a bargain during their working years so that those who are younger will support them when they are retired. In a world of endlessly overlapping generations of workers and retirees, what will the pattern of interest rates be? This appears to be a factual rather than an evaluative question, and obviously it is a very abstract issue. To isolate the effect of this desire to provide for one’s old age from other factors that influence the rate of interest, Samuelson formulates an extremely simplified model in which everyone lives exactly three periods. In each of the first two periods of their lives, people produce one unit of a completely perishable consumption good. In the third period people produce nothing and can survive only if those who, in the first two periods of their lives, support them. To simplify further, Samuelson considers first an absolutely unchanging economy and then one growing eternally with an unchanging rate of growth and an unchanging rate of interest. In these models a “biological” rate of interest equal to the rate of growth clears all markets and is optimal (in the sense that there is no way to make some people better off without making others worse off). For example, in the case of no growth at all, individuals can “save” one-third of their output in each of the two periods in which they are productive and then maintain the same level of consumption ($2/3$ unit) during retirement.

But is this outcome socially feasible? Remember that output is perishable and cannot literally be saved. The one-third of their output that young and mature workers do not consume constitutes the $2/3$ unit of the good that retired workers consume. What is here called “savings” is in fact a transfer to retired workers. Why should current workers transfer anything to the retirees? After all, the retirees never gave anything to these workers, and

3.3 Conclusions

That the arguments economists make about important matters include an ethical component should be neither a surprise nor a cause for regret. As our second example shows, this ethical dimension is present even in a controversy concerning abstract overlapping generations models, as well as in contexts (such as unemployment or school vouchers) fraught with policy implications. So long as economists deal with socially consequential subjects, some (but certainly not all) entanglements of fact and value will be unavoidable and proper.

The best way to cope with these entanglements is to make them explicit and to address *both* the economic and the ethical issues. If there is any implicit criticism of the economists in the examples discussed in this chapter, it is that they have not always achieved the same level of analytical clarity and critical self-awareness in the parts of their work that connect with ethics as they have sought in the rest of their work. Our aim in the following chapters is to clarify different ethical approaches and to help readers to think about them rigorously.

Suggestions for Further Reading

Our discussion of involuntary unemployment was heavily influenced by De Vroey (2004). The debate about whether unemployment is involuntary is connected to the larger question of whether the transactions that compose a market economy are voluntary. A classic defense of that view is in Friedman (1962, ch. 2). An economist's argument that market systems have coercive elements can be found in Okun (1975). On voluntariness in market transactions see also Peter (2004). A good overview of the literature is Yellen (1984).

Paul Samuelson's (1958) overlapping generations model has been much discussed. For an overview of its influences and of the permutations the basic model has undergone, see Hausman (1992, ch. 7).

Questions for Study and Discussion

1. Economists who maintain that unemployment is voluntary usually favor less government intervention in the labor market, whether in the form of unemployment insurance, minimum wages, or government hiring. They also typically hold an unfavorable view of unions.

Economists who maintain that unemployment is involuntary typically favor more government involvement and assistance and are more favorably disposed toward unions. Why?

2. If the only jobs available to the unemployed do not pay enough for them to feed themselves or find a place to live, then it seems implausible to maintain that they are voluntarily unemployed. But if the unemployed have the option of taking jobs that do not imply starvation or homelessness, should we regard their unemployment as voluntary? What about someone who has trained to be an intensive-care nurse and who turns down a lesser job as a cardiac-care nurse? How should economists distinguish between voluntary and involuntary unemployment?
3. While they were working, those who are currently retired accumulated claims to goods and services, whether in the form of cash or other assets, that could be exchanged for the goods and services retirees consume. Meckling asks the question "Why should those who are now working give any of these goods and services to those who are no longer working?" How would you answer him? Does your answer explain why materially self-interested individuals supply goods to retirees?
4. Should we think of the social security program as a mandatory form of individual savings for retirement, or should we think of it as a social program whereby the young support the old? In other words, is it a savings program or a transfer program? Or is this a false dichotomy?
5. There are deep disagreements concerning the slow current rate of growth of most advanced economies, with some economists arguing that the problem lies with too much government debt, too much taxation, too much government regulation, and a consequent lack of confidence on the part of businesses, who are reluctant to invest. Others argue that the problem lies with inadequate overall demand and that more government borrowing (which can be done at low cost, owing to low interest rates) can improve infrastructure and lead to increased investment and growth by increasing demand. These are disagreements about factual matters. What, if any, influence do you think that ethical considerations have on these disagreements?
6. Do you think that it is possible to formulate an economic theory that, unlike the examples in this chapter, shows no influence of normative concerns? Why? Can you think of an example?