

Do Economists need to choose between Efficiency and Justice?

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Tonight, I want to address the question whether it is sometimes necessary for economists to make a choice between efficiency and justice. I had an interesting conversation about this topic with a high school friend of mine during the summer of 1992. I had just finished my first year of graduate school, and over a beer I explained how economists could solve all the pressing problems of the world—if the world just let them. After listening to me for about half an hour, he pricked my inflated ego by asking: “Florenz, don’t you think that there are times when we must ignore efficiency and only try and find a fair solution?” I do not remember my response, but I do remember that it did not satisfy either of us. During the following years, I often thought about his question. While I worked on my dissertation in 1996, I found a surprisingly simple answer:

Good economists never need to choose between efficiency and fairness. They have already settled the issue when they decided what kind of an economist they want to be.

This answer may startle those who think that there is only a single approach to economics. But “economics” is a social science, and there are many different ways to address social issues. Neoclassical economics is the most popular approach, at least in the United States, but it is not the only one. There are also Austrian Economics, Keynesian Economics,

Institutional Economics, Ecological Economics, Feminist Economics, and Marxist Economics, to name only a few. A main difference between these approaches is in their fundamental views of social relations. Because their starting points differ, they usually reach different conclusions. Unfortunately, people often evaluate—and criticize—different approaches to economic analysis by focusing almost exclusively on their conclusions. It would be much more fruitful to evaluate the differences between their starting points instead.

So let us begin at the beginning. Economic is a social science. What should be the primary focus of social analysis? Should economists focus mainly on the individual or mainly on her community? On a first account, the individual seems to be the obvious choice: a community consists of individuals, so we certainly cannot ignore the individual. But the community often influences the goals, desires, and the behavior of individuals, so economists cannot ignore the community either. The question therefore is not whether we should focus on the individual or on the community, but rather: when should we focus on the individual and when should we focus on her community? Our answer to this question determines which approach to social issues and to economics we favor.

Let us consider a practical example. Many social questions arise with respect to the allocation and distribution of resources. Assume that two children sit under an apple tree. The question is: how many apples does each child get? We can approach the question from different angles. For example: do the children have a say in this? Or are they likely to just spoil their appetite for dinner if we let them make the decision on their own? Does the interest of families to have harmonious dinners together outweigh the interest of the children to eat when they are hungry? In what respect are family norms binding in this case? Does it matter if one child is hungry while the other is not? Is it relevant whether one child is physically

stronger than the other, so that it can take all the apples if it chooses so? Does it matter if one child belongs to the family that owns the tree?

These are normative questions and there is no “right” answer to any of them. Nevertheless, most of us can say what we think the answers should be. If all of us could agree on the same answers, then nobody would object to the rules that we choose of how to divide apples among children. In most cases, however, we will not reach such unanimous agreement. How we should handle disagreement? The rules that apply in cases of such disagreement illuminate the difference between Morality and Justice. As long as I am not willing to intervene if my society chooses an answer that I don’t like, I remain within the realm of Morality. Morality tells me how a good person should behave, but Morality does not compel me to ensure that everybody behaves in this fashion. For example, I might think that a moral person should go to church on Sundays, but I am not prepared to force you to go to church if you don’t want to.

Sometimes, however, we feel so strongly about a particular issue that we are willing to intervene if others do not accept our preferred solution. In such a case, we have touched an issue of Justice. Justice tells us how a group of persons should settle conflicting claims. If a member of the group does not follow the rules of justice, then the group is entitled to enforce these rules. For example, we might decide that it is unjust behavior if one person steals from another, and that we are justified to force a thief to return stolen property. Forcing a thief to return stolen property is therefore an act of justice. You might ask: isn’t this the same as “law?” But Justice is not the same as the law, because laws can be unjust. Rather, Justice is the standard to which we hold the law accountable. You can say that Morality provides a framework for your own good behavior, and that Justice provides a framework for all members

of your society within which they need to resolve their disputes. Just laws represent the codification of Justice.

If Justice is a framework for society within which to resolve disputes, then what is the right framework? For many centuries, philosophers have tried to discover the “right” theory of morality. But they all encountered David Hume’s powerful dictum that it is impossible to deduce “ought” from “is.” To draw normative conclusions (as in “therefore this apple is rightfully yours”), it is necessary to start with normative assumptions (as in “society is entitled to enforce certain property laws”). We cannot find the right theory of Justice unless we somehow manage to discover the “right” normative assumptions. But what are the right normative assumptions? We don’t know. All we can hope for is to find a set of attractive rules that the people we live together with can agree on.

Political philosophers have proposed many different sets of rules that provide frameworks for settling conflicting claims. A major difference between these theories of justice is the emphasis that they put on the individual and on her community. At one end of the spectrum are theories of libertarianism that defend the largest individual freedom that is compatible with the freedom of others. At the other end are theories of communitarianism that focus on human interactions and the relationships of power that emerge from these interactions. And there are many theories in-between.

Before you can begin to make the world a better place, you need to decide what a better world should look like. Before you design rules to govern the allocation and distribution of resources, you need to decide what the standards of these rules should be. Before you can start allocating resources efficiently, you need to decide when efficiency is desirable. In short, before you can become an economist, you need to choose a theory of justice. Your theory of

justice determines what approach to economics you should choose. If your two choices are compatible with each other—as they should be—then you will never face a conflict between efficiency and justice. This is what I meant when I said that good economists do not need to choose between efficiency and justice.

I have met few economists who have actively thought about the theory of justice that is behind their approach to economics. This is unfortunate, because I believe that this omission is often at the root of disagreements between economists and non-economists. Economists often state the policy recommendations that they deduce from their models in a way as if they were absolute Truths. But we know that it is impossible to make normative policy recommendations without having a normative social framework—a theory of Justice—in the background. Those who do not accept the theory of Justice that is behind a particular economic analysis will naturally not be persuaded by the normative implications of the economic model. If economists were to recognize and emphasize that their policy recommendations are valid only within the normative framework of their models, then the public debate would focus on the real issue: “Which theory of Justice is appropriate for our society?” rather than on the technical question: “How to allocate scarce resources efficiently?”

Most economists in the United States follow the so-called neoclassical approach. What theory of justice is behind neoclassical economics? As it turns out, neoclassical economics is not built upon a single theory of justice, but it is influenced by three different “-isms”: Classical Liberalism, Utilitarianism, and Conservatism.

Classical liberalism is behind most of neoclassical economic thought. A cornerstone of classical liberalism is that it takes the preferences of individuals seriously. Neoclassical economists have very little to say about how preferences are formed. Some critics see this as a

major shortcoming. When I participated at the Open house at Binghamton University two years ago, I sat next to a faculty member from the Geography department. After I had introduced myself as economist, he tried to convince me that economists have not achieved much during the past 200 years. “You economists,” he said, “did not even manage to develop a satisfying theory of how humans develop their preferences. Obviously, such a theory ought to be at the center of economic analysis if economists want to analyze human behavior.”

I believe that he was wrong, because he ignored the liberal foundations of neoclassical economics. From a classical liberal perspective, it is not important why someone has a certain preference, but rather that she has this preference. Classical liberalism neither judges a person’s preferences nor prescribes how people should behave, but rather takes the preferences of individuals as given. Classical liberals believe that individuals have the right to choose their own goals, as long as these choices do not conflict with the rights of others. Classical liberalism emphasizes such individual rights, and does so irrespective of the consequences that these rights might have for social welfare.

Some areas of neoclassical economics have implicitly abandoned the liberal foundation and adopted a utilitarian theory of justice. From the utilitarian perspective, a society should adopt those policies that maximize social welfare. Unlike liberals, utilitarians emphasize the consequences of an action. Rights are important only if they help to bring “the greatest good to the greatest number of people.” Critics have pointed out that, in order to maximize social utility, one has to aggregate utility functions across persons. But to do that, one needs an adequate yardstick that one can use to measure a person’s utility and make utility comparable across individuals. So far, nobody has been able to suggest anything that could serve as such a yardstick, which greatly reduces the practical value of utilitarianism.

I see little possibility to combine utilitarian and liberal theories of justice.

Utilitarianism focuses on the social consequences of a policy under disregard of individual rights. Liberalism emphasizes the protection of individual rights from utilitarian planners. Any attempt to maximize social utility through a social welfare function conflicts with individual rights at some level. The fact that both theories influence neoclassical economics reduces the coherence of its foundations. It would be desirable to replace the utilitarian influence with liberal criteria.

Before I suggest such a replacement, it is necessary to consider the third theory of justice that influences neoclassical economics. By taking not only individual preferences but also individual endowments as given, neoclassical economics does not question the justice of existing property rights. Implicitly, economists accept a conservative theory of distributional justice. This is most apparent in the Pareto principle, which states that “a change can be called improvement only if it makes some individuals better off without making a single individual worse off.” The Pareto principle seems attractive because it protects the rights of minorities: it prevents changes that would improve the welfare of many at the expense of a few. But this is not always desirable. The Pareto principle requires that one compare all proposed changes to a given state of the world—the status quo—regardless of whether this state was attained by just or unjust methods. For example, according to the Pareto principle, a proposition to abolish slavery will only lead to social improvement if society compensates slave owners for their lost property. The fact that society now deems it unjust to consider human beings as property does not matter. The only thing that matters is the status quo before the proposed change, and slavery can be abolished only if its abolition does not leave anyone, not even slave owners, worse off.

Liberal theories, on the other hand, do consider the way the status quo was attained. If it was attained through unjust actions, then it cannot be used as adequate point of comparison for change. If it is unjust to consider a human being as property, then slave owners do not need to be compensated if society decides not to respect the property rights of slave owners in the future. There is a very basic conflict between liberalism and the conservative Pareto principle.

It would be desirable to base neoclassical economic theory only on a single—a liberal—theory of justice, rather than on three conflicting theories. This would help to clarify the assumptions of economics theory and make them more coherent. It would also make it easier to answer some of the criticism of neoclassical economics, which is frequently more ethical than technical.

Which liberal criteria should take the places of utilitarianism and the Pareto principle? Utilitarianism says that we should do whatever maximizes total utility. The Pareto principle says that proposed changes may not violate existing property rights. Liberalism says that we need to provide all individuals with the liberties and resources necessary to act upon their own beliefs. This implies that, rather than trying to maximize total utility, we need to define the rights of individuals that society should protect. We must decide how many of which resources an individual needs to be able to act according to her beliefs, and how and by whom these resources are to be provided. This is closely related to the issue of private property rights and distributive justice: Which resources can be claimed for exclusive private use, and which are to be shared with others?

The classical economists had a framework that is very well suited to address this question. They divided resources into three mutually exclusive categories. Human beings were classified as “labor.” Everything that was produced with human effort was classified as

“capital.” Everything that was neither a human being nor produced with human effort was called “land.” Which resources can be claimed for private use? There is of course no intrinsic reason to exempt any category from being considered common property. For example, there is no intrinsic reason to assume that human organs or human talent must be the private property of the person in whom they are embodied. A society might decide that it is just to require those who have two functioning kidneys to provide their spare kidney to those who have none.

Classical liberalism, however, is built upon the principle of self-ownership. This principle defines a birthright of the individual over her own body, her own talents, and her own goals, which cannot be taken away and which is therefore not available for redistribution. Classical liberals also object if things that are produced with human effort get classified as common property. They argue that individuals should have the liberty to define their own goals and to act upon their own beliefs. This principle seems violated if a person has the liberty to produce on the one hand but society does not permit her to keep what she produces on the other. From a classical liberal perspective, both labor and capital are considered private property.

It is considerably more difficult, however, to defend private ownership in non-produced resources, or land, with liberal principles. Private ownership in non-produced resources can only be established in two possible ways. Either the person who discovers the resource first acquires exclusive ownership. This places later generations at a disadvantage, and is difficult to combine with the liberal principle of equal rights. Alternatively, the non-produced resource might become the property of the strongest person. Neither “first-come-first-serve” nor “might-makes-right” is defensible with liberal principles. From a classical liberal perspective, land should be considered common property.

Henry George pointed out that it is not necessary to transfer ownership in land from private owners to the government to reach this goal. It is only necessary to impose a tax on land to collect the benefits of non-produced resources for public use. Henry George proposed that we abolish taxes on labor and capital, which unjustly confiscate private property, and replace them with a Single Tax on land. If neoclassical economists accepted a tax on land as part of their economic doctrine, then they would make a large step to harmonize the ethical foundations of neoclassical economics. Rather than being at odds with neoclassical economics, I believe that the Single Tax on land will fill a void. This is why I can stand in front of you and say: as a neoclassical economist, I never have to make a choice between efficiency and Justice. I already made that choice when I became a Georgist. Thank you.