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Can't Touch This! Private Property, Takings, and the Merit Goods Argument

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CAN'T TOUCH THIS!
PRIVATE PROPERTY, TAKINGS,
AND THE MERIT GOODS ARGUMENT

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*Goutam U. Jois**

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Abstract

Over the past decades, economic theory has gained increasing influence in legal thinking, political theory, and public policy. This article argues that the popular characterization of economics as “value-neutral” obscures the fact that there are fundamental value judgments in any framework influenced by economics. Acknowledging this fact will shift the terms of the debate: instead of a “neutral” policy and one that “imposes values,” we see that both policies in fact entail values imposition to some extent. The public discourse is thus rendered more intellectually honest.

The article progresses in three parts. First, I describe the concept of “merit goods.” This concept, introduced fifty years ago, has met with resistance from traditional economists because it justifies interference with individuals’ preferences and imposing values, something economics ostensibly rejects. Second, I show that the merit goods concept nonetheless can be used to clarify U.S. Supreme Court cases regarding regulatory takings, indicating that values imposition is not just a theoretical matter. Finally, I survey the writings of Hayek, Nozick, Buchanan, and Posner to show that even those authors who claim to be true to the principles of economics nonetheless have elements in their theory that involve imposition of certain values — that is, involve merit goods.

Merit goods, then, enrich those scholars’ theories, properly describe constitutional reality, and add a needed dimension to economics.

I. Outlining the Problem

In Haddonfield, New Jersey, the main street bustles on a Friday afternoon. Families eat lunch, young couples enjoy a stroll, and a group of teenagers converges on the town square for (what we hope is) some good,

clean fun. Jewelry stores, antique shops, and sidewalk cafés are preparing for the early evening rush. But very few lawyers, accountants, or insurance agents are returning from lunch. In fact, no service-sector employees work on the first floor of any building on Kings Highway — a town ordinance passed in the mid-1990s prohibits it. The Haddonfield Town Council, deciding that sidewalk pedestrian traffic was something that the community should value, has required since then that all first-floor storefronts on Kings Highway be walk-up retail establishments.

—

Many people complain that there is a significant housing shortage in Northwest Washington, DC. Rents prices are almost unbearably high and even the relatively affluent neighborhoods hear grumblings about the need for rent control laws. Universities are harshly scrutinized when they wish to expand student enrollment, and finding on-campus housing has been a problem. Why, then, doesn't a large realtor build a thirty-story apartment building? Supply would increase, prices would drop, businesses would make money, and all parties would be happy. The only catch is a century-old law that prohibits buildings in the District of Columbia any taller than the Capitol Building and Washington Monument. Residential and commercial shortages of space, Congress decided, are the price we must pay so that the district may have a "unique skyline."

* * *

This Article is premised on a simple notion: that any policy, no matter how "neutral" it might seem, inevitably requires imposing one set of values on society over another. If this is true, then our public discourse — about law, economics, and politics — will be more open and intellectually honest if we acknowledge and debate the merits of those values instead of pretending that some policies are "value-laden" while others are "value-neutral."

The preceding examples show how laws can very explicitly affect what choices individuals may or may not make — in these cases, interfere with an individual's right to use her property as she wishes. But on what grounds does such interference take place? Indeed, who knows better than a given individual what is best for her?

Broad questions like these have been debated for centuries, and it is not my intention to resolve them now. However, one fact on which most people can agree is that certain government policies do interfere, to a greater or

lesser extent, with the preferences of certain members of the polity. Given this reality, the task for political theorists and political philosophers is to provide a framework that can accommodate these policies. Insofar as a given framework cannot, that theory can be considered incomplete: after all, policies that clash with the underlying framework are not only anomalous but also illegitimate within the bounds of theory.

There are then two ways to proceed. First, we could deny that policies such as these exist and, to the extent that they do, advocate their elimination. I take this to be fundamentally unfeasible. Doing so would not only overhaul the nature of our political system but also likely be rejected by our citizenry. One need only look at the overwhelming support for publicly subsidizing the arts to realize that Americans generally favor coercive governmental action for some higher, nobler, or more altruistic “good.”¹ The extreme individualist might argue that the fact that citizens favor interference doesn’t make it right; the moral issue at stake is that interference is bad and therefore those policies ought to be eliminated. Of course, this brings us right back to the problem of imposition, since, paradoxically, we would have to interfere with the wishes of a significant portion of our population toward the purported goal of reducing interference. Moreover, as I demonstrate later in this Article, even the “pure” libertarian position of market-based noninterference nonetheless requires imposition of certain values.

On the other hand, we could provide a means for conceptualizing the policy problems that fall outside the existing theoretical framework. Specifically, there are particular strains of legal and political theory — those that enjoy very strong influence today — that place a very high value on individual liberty, autonomy, and free market economic policies. Since interference with individuals’ preferences exists, and since many people seem to *want* it to exist, those theories must, to some extent, be considered incomplete or limited. It remains for the theoretician to provide an adequate framework to capture those policies. Insofar as mainstream theory does not account for those policies, it can be considered incomplete.

I have alluded several times now very loosely to “theory.” But where and why exactly does “theory” have a problem with imposed preferences? We can start with economics, where the clash between individuals’ right to choice and imposed preferences is manifested most starkly. Classical economic theory is predicated on the assumption that individuals are self-interested, utility-maximizing rational actors. Even when action is

¹ National Opinion Research Center. [GSS 1998 Codebook \(#686, NATARTS\)](http://icpsr.umich.edu:8080/GSS/rnd1998/merged/inde-sub/artandli.htm) [website]. 1998. <<http://icpsr.umich.edu:8080/GSS/rnd1998/merged/inde-sub/artandli.htm>> 3 December 2002.

collective, as in the pure public goods argument, an economist would argue that individuals are only acting as a group to maximize their particular utilities.

By and large, our economic reality bears this out. We have a (mostly) unregulated free market system at work, and the regulations that we do have are generally defended as necessary for the operation of the market. In cases where individuals' action is somehow limited, we generally hold that those individuals should be compensated for their inconvenience. Thus, even if a collective decision is made to build a road through a person's property, he is compensated at fair market value for the property he loses. Most important, there is no net loss of utility and economic efficiency is honored.²

But the fact that interferences are (seemingly) rare is not reason to ignore them; indeed, it becomes all the more important to examine *why* theory has no space for these instantiations. A weakness in theory, no matter how subtle, undermines that theory.

We can now move from economic theory to the focus of this article, legal and political theory. Politics is, after all, the institutional mechanism by which economic (and all other) policy decisions are made and carried out.³ The question of interference, which we originally cast in economic terms, is therefore extremely important in law as well. Specifically, certain strains of liberal democratic theory, including those most prevalent in the United States, are strongly influenced by market economics and individualism. Such liberals, including Friedrich Hayek, Robert Nozick, and James Buchanan, hold the individual's right to free choice to be

² A Pareto-optimal solution is one that, at a minimum, makes no one worse off and one person better off, thus moving society to a higher point of economic efficiency. Generally, when I use the phrase "economic efficiency" in this Article, I am referring to Pareto efficiency. There is also an alternative formulation of economic efficiency: Kaldor-Hicks efficiency. By this formulation, a policy is efficient if the net gains to the "winners" are greater in magnitude than the net losses to the "losers." Thus, the winners could compensate the losers to eliminate their loss while still being better off themselves. But under the Kaldor-Hicks formulation, compensation *in fact* is not necessary. While many policies are defended "efficient," their advocates are usually thinking of Kaldor-Hicks efficiency, not Pareto efficiency. But the Kaldor-Hicks formulation, while hailed as simpler, has its own problems. It is often difficult, if not impossible, to know the full range of costs and benefits. "Efficiency" then becomes a shibboleth at best, deceptive at worst. Since the ideas of voluntary exchange and consumer sovereignty are at the heart of economic theory, I employ the concept of Pareto-optimality in this Article. See generally RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 10-16 (2002).

³ A good discussion of the relationship between the economic costs associated with political decisions can be found in Geoffrey Brennan, *Irrational Action, Individual Sovereignty, and Political Process: Why There Is A Coherent "Merit Goods" Argument*. In *RATIONALITY, INDIVIDUALISM AND PUBLIC POLICY* (Geoffrey Brennan & Cliff Walsh, eds. 1990).

paramount.⁴ Indeed, there is a very strong sense in which these authors use economic tools, economic frameworks, and economic theory all as *political* tools. I certainly do not want to paint liberal democratic theorists with the same brush. Indeed, the development in the literature since Hayek's or even Nozick's time is considerable. For example, Rawlsian liberalism appears to allow a significant theoretical space for policies that do not categorically uphold autonomy (for example, the difference principle favors those that are worst-off at the expense of those better-off).⁵ However, individualism still runs deep in American society, and has a long and exalted history in our country. Examples range far and wide, from Tocqueville's observations of the "rugged individualist" to Emerson's essay on self-reliance to contemporary advertisements for an "Army of One." As long as America considers herself to be a "nation of individuals," there is a gap between theory and reality that must be addressed.

At this point I want to make a note about wording. In this Article, I will refer repeatedly to the distinction between left- and right-liberalism. This dichotomy largely follows the one put forth by Louis Hartz in his book, The Liberal Tradition in America. Hartz writes that "the right in America . . . exemplifies the tradition of the big propertied liberalism in Europe. [It] . . . embraces loosely the English Presbyterian and the English Whig, the French Girondin and the French Liberal." This tradition, he says, has as one of its characteristic features the fact that it "loves capitalism."⁶ To refer to these liberal democratic theorists, I use the term right-liberal. However, in contemporary parlance, it is not uncommon to call these theorists neoliberals, libertarians, or even conservatives (the latter two largely in the United States and the first largely in Europe). However, it is appropriate to consider all of these authors "liberal" insofar as they all follow in the tradition of authors like Locke and Mill. Hayek, for example, traces his theory directly back to Adam Smith and John Locke.

In contrast, left-liberals are those for whom the European "petit-bourgeois" is a starting point. Hartz notes that while the American tradition is considerably more complicated — for example, it included both the peasantry and the proletariat into its structure — "the basic correlation remains a sound one."⁷ Thus left-liberals, including John Rawls, are those

⁴ See, e.g., Friedrich A. Hayek, *THE ROAD TO SERFDOM* (1944); Robert Nozick, *ANARCHY, STATE, AND UTOPIA* (1974); and James M. Buchanan and Gordon Tullock, *THE CALCULUS OF CONSENT* (1962). This issue will be discussed in considerable detail in Section Three.

⁵ John Rawls, *A THEORY OF JUSTICE* 75-83 (1971).

⁶ LOUIS HARTZ, *THE LIBERAL TRADITION IN AMERICA: AN INTERPRETATION OF AMERICAN POLITICAL THOUGHT SINCE THE REVOLUTION* 15 (1955).

⁷ *Id.* at 15-6.

who are less strongly influenced by market process and are more concerned with outcomes of the political system, rather than processes.

The problem is fairly well outlined: while certain types of legal and political theory, including those particularly prevalent in our society, value individual choice and freedom, there are many *needed* policies that do just the opposite. The task for political theory is now to examine how those policies can be justified.

The issue is especially important in law. Over the past few decades, law and economics scholarship has become progressively influential in legal academia. Richard Posner's famous positivist thesis, that the common law was actually geared toward economic efficiency, was a watershed moment; since then, a variety of prominent scholars have increased the profile of law and economics.⁸ These and other scholars generally adopt the basic tenets of economics: that voluntary choice should be at the heart of policy and that legal rules should be oriented toward utility maximization.⁹

But these scholars assume that legal rules *can* be value-neutral, a claim that I categorically reject. At the most basic level, all market mechanisms involve value imposition. Indeed, as Roberto Unger has pointed out, it is not an "unregulated" market that economists advocate, it is a market functioning under nineteenth century common-law definitions of contract, property, and tort.¹⁰ Value judgments — indeed, about precisely what "fairness" conditions are necessary to promote "welfare" — thus underlie any conception of the market.

But the issue runs deeper. Even if the value judgments establishing the market are assumed away, there are nonetheless policies, in law and in

⁸ Some of the most prominent scholars include Judges Richard Posner and Frank Easterbrook, William Landes, Gary Becker, and Ronald Coase, all associated with the University of Chicago; Lewis Kaplow and Steven Shavell of the Harvard Law School; Mitchell Polinsky at Stanford; and Judge Guido Calabresi of the Second Circuit (affiliated with Yale).

⁹ See, e.g., Lewis Kaplow and Steven Shavell, FAIRNESS VERSUS WELFARE 3-4 (2002), in which the authors argue that "legal rules should be selected entirely with respect to their effects on the well-being of individuals in society. This position implies that notions of fairness like corrective justice should receive no independent weight in the assessment of legal rules.

¹⁰ Roberto M. Unger, Lecture, Spring 2005. This is similar to claims that others have put forward, including Nobel laureate Joseph Stiglitz, Whither Reform? Ten Years of the Transition, *In ANNUAL WORLD BANK CONFERENCE ON ECONOMIC DEVELOPMENT*, (Boris Pleskovic and Joseph E. Stiglitz eds., 2000), and philosopher Wilfried Ver Eecke, *The Concept of a "Merit Good": The Ethical Dimension in Economic Theory and the History of Economic Thought or The Transformation of Economics Into Socio-Economics*, 27 J. OF SOCIO-ECON. 133, 138-40 (1998).

economics, which exhibit interference with the consumer sovereignty norm and, by extension, involve value judgments. Finally, even if those policies are bracketed off, the libertarian and economic-minded scholars *themselves* advocate policies that involve interference with consumers' preferences. Taken together, all of these suggest that (1) "value-neutrality" in establishing legal rules is impossible; and (2) legal, economic, and political discourse can be rendered more open and intellectually honest if scholars are forced to articulate and explicitly defend the values at play in their policy proposal.

In this Article, I will argue that the concept of merit goods — which explicitly allows for interference in market mechanisms to make value judgments — can be applied to legal issues to show a significant limitation in the theories of right-liberals who seek to apply free market ideals to the law. In doing so, I will demonstrate that the concept of merit goods allows democratic theorists to retain the assumptions, unit of analysis, and explanatory power of economic theory, while demonstrating the shortcoming of certain theoretical prescriptions.¹¹ I will do this by explicating the concept of merit goods, applying it to clarify Supreme Court doctrine relating to regulatory takings, and situating the concept in political and legal theory.

The task thus proceeds on two fronts: on the one hand, I argue that the only way to understand certain policies in our society, such as regulatory takings doctrine, is by recognizing the values that underlie those policies, which the merit goods concept illuminates. But there are those scholars who would argue that those policies are themselves illegitimate. Thus the next task — undertaken in Part IV — shows that even those authors considered libertarians themselves promote theories that involve imposition of certain values. They do this, not because they are untrue to their own theories, but because it is impossible not to do so.

I choose the concept of merit goods because it was born when puzzling over the problem of interference with consumer sovereignty and thus most aptly describes the policies I address. In his 1957 Article, "A Multiple Theory of Budget Determination," economist Richard A. Musgrave wrote that "[w]here interference with individual preferences is desired, our

¹¹ In this Article, I will use, and cite economists who use, the term "normative." Economists often distinguish between "positive" and "normative" economics — that is, the empirical science and the prescriptive. Thus when I refer to the prescriptions of economic theory, I am referring to what an economist would call "normative economics."

schema must be expanded. Such wants . . . I refer to as merit wants.”¹² This relatively simplistic definition spawned a significant corpus of literature on the subject of merit goods. Specifically, authors debated (and in some cases are still debating) the legitimacy of a concept that directly contradicts the assumptions and underpinnings of economic theory. Their reactions varied widely: from rejecting the new concept, to limiting it, to redefining it, and even expanding it. In the first section, I will show that the concept of merit goods inherently involves a value judgment on the part of public authorities: a phenomenon for which legal theorists, insofar as they are influenced by economics, cannot account.

Furthermore, other authors — from Nobel laureate economists to political scientists to philosophers — have written about policies from famine relief to birth control to education that present clear interferences with individual preferences. The concept of merit good, which provides a theoretical basis for such interference, justifies their analyses.¹³ As such, I will argue that merit goods are the best tool with which to address, and ultimately justify, the interferences with which we are concerned here.

Therefore, Part II of this Article deals exclusively with the merit goods concept. I begin by providing a comprehensive definition of the concept used throughout the rest of this paper. Then, I trace the development of the concept over the past five decades. At the end of the section, I provide the reasons for which merit goods — initially an economic phenomenon — are now a necessity in our political discourse as well.

Part III applies the merit goods concept to a legal issue. I examine regulatory takings jurisprudence, because the interference entails limiting what individuals are permitted to do with private property. While interference can, and certainly does, take many other forms, I believe this is of particular interest. Liberal scholars from John Locke and Adam Smith to the present hold private property to be one of the most fundamental rights of individuals. Part III examines a series of Supreme Court decisions that deal with regulatory takings. By how the merit good argument explains these cases, I show that the concept has important applications in our legal reality. Moreover, this is a “threshold case” for merit goods analysis: if the concept is applicable against interference with the right to property, it would seem

¹² Many authors use the term “merit wants,” while I use the term “merit goods.” These are interchangeable. Similarly, “public wants” and “public goods” are interchangeable while referencing non-exclusive goods that are provided Pareto-optimally (I will use public goods).

¹³ For a summary of the applicability of the merit goods argument to these other disciplines, see Goutam U. Jois, *Consumer Sovereignty Re-examined: Applications of the Merit Goods Argument*, *In REAL-WORLD ECONOMICS* (Edward Fullbrook, ed. 2006) (forthcoming). This chapter not only illustrates the justifications for the interferences outlined above but also shows that the merit goods concept is inherently interdisciplinary.

that other cases of interference could be similarly justified. This case study will be the focus of Part III.

Part IV shows how merit goods situate themselves against libertarians' use of free market economics as a tool of democratic theory. Interestingly, merit goods are a problem only in democracies. It seems intuitive that the both liberals and conservatives who sought to *limit* popular participation would have no problem with the concept; indeed, merit goods might provide a theoretical home for their policies. However, liberals who value some degree of participation and autonomy will have a harder time accepting a concept that, at least on face, directly attacks those norms. This fact becomes worrisome for some writers; Musgrave, for example, notes repeatedly that the concept of merit goods opens the door to abuse by a malicious regime. Of course, the possibility of abuse exists to some degree in virtually all political theories; this is by no means a sufficient reason to reject the concept out of hand. Thus in the final section, I present the libertarian's position as a contrast to the concept of merit goods. Then, I will show how merit goods reasoning is nonetheless implicit in these authors' theories.

Part V concludes.

Before beginning, I want to make explicit a very important underpinning to my study: I believe economic theory not only affects legal and political theory but also our reality. When legal rules are put forth — for example, environmental regulation or health care — that clearly violate the paramount economic norm of efficiency, proponents of that policy are unable to engage in dialogue with economists on the subject. I consider this a significant problem. Indeed, the hegemony of economics in the social sciences can be seen in the application of microeconomic theory to everything from pollution control to racial discrimination to sex and marriage.¹⁴ Now more than ever legal rules must acknowledge, if not engage, economics.

This is necessary for two reasons: first, the economist does not have an adequate theoretical apparatus with which to advocate policies that might be inefficient but otherwise necessary. More important for our purposes, legal theory is unable to engage and ultimately refute economists' claims holding

¹⁴ One of the best-known scholars who sought to apply economic thinking to other disciplines was Gary Becker. Robert H. Nelson, *infra* note 159, makes repeated reference to Becker in his book and Judge Richard Posner refers to Becker as one of the pioneers of the law and economics movement. Posner, *infra* note 184, at 24. Becker's works include *THE ECONOMICS OF DISCRIMINATION* (1971) and *THE ECONOMIC APPROACH TO HUMAN BEHAVIOR* (1976).

efficiency to be the exclusive goal of public policy. In a sense, economic theorists and legal theorists are speaking two different “languages.” But since law provides the institutional mechanism for application of economic prescriptions, legal theorists must be able to refute economic arguments on their own terms. Earlier, I commented that American society is infused with strongly individualistic beliefs. Similarly, American legal processes are (to a much greater extent than in other countries) infused with strongly individualistic economic beliefs. Our distinction between left- and right-liberalism becomes important once again. First, right-liberals’ theories will be made more intellectually honest by recognizing the concept of merit goods. But also, the concept will provide a meaningful mechanism through which left-liberal theorists can advocate politically and economically acceptable interferences with individuals’ preferences.

The merit goods concept is vitally important because it demonstrates that *all* theories — including those of ostensibly value-neutral economists and political philosophers — involve fundamental value judgments. Once these value judgments are exposed, the entire frame of debate shifts on many important policy decisions. The merit goods concept shows that, for example, instead of choosing between a “free” market and regulation, policymakers are in fact choosing between two forms of coercion, both of which involve important ethical and moral judgments. Once these value judgments are “out in the open,” the democratic process can operate with increased information and openness. The polity can decide which values are in accord with community ethics — instead of assuming that some distribution of costs and benefits across groups is inherently just, fair, or natural.

Such a contribution to the theoretical discourse is the aim of this Article.

II. A Round Peg in a Square Hole

In this Article, I will explore the applicability of merit goods reasoning to land use regulations as a way to demonstrate not only that interferences with individuals’ preferences are commonplace in law but also that they are a necessary part of right-liberals’ political theories.¹⁵ To do so, however, it is necessary to have a sound understanding of the merit goods concept. In this section, I present the working definition of merit goods for this Article.

¹⁵ Through the rest of this Article, I will focus my discussion on right-liberals and traditional legal economists. I show first that the theories of the authors I present are necessarily limited and second that the theories implicitly rely on the merit goods concept. *See infra* Part V.

I then trace out the relevant developments in merit goods literature over the past five decades.

In law, politics, and economics, battle lines are often drawn between those who would impose certain values (say, universal health care) and those who would rather be neutral and let markets work things out. As the law and economics movement has gained prominence, the latter view has become particularly influential. The merit goods concept is thus critical, because it illustrates that even the most fundamental, “neutral” economic theory cannot avoid the imposition of value judgments.

a. Definition of the Concept

A “merit good” may simply be defined as a good of which authorities believe too little is being consumed. As such, they implement measures to increase consumption. The opposite of a merit good is a “demerit good,” in which case too much of a good is being consumed and authorities implement measures to reduce consumption.¹⁶

However, as mentioned in the introduction, the concept has been the subject of much critical debate in the economic community over the past forty-five years. This is primarily because, as Musgrave indicates, the concept exemplifies cases where “interference with individual preferences is desired.” Such interference is manifestly incongruous with liberal economic theory, which claims to maximize of individual preferences.

The problem is particularly acute because economics is both descriptive and prescriptive. In addition to telling us how the world *is*, economists (and especially legal economists) tell us how the world *ought to be*. As a prescriptive activity, economics was unable to accommodate the merit goods concept within its framework; this led to the debate on the topic.

Given the wide range of ongoing controversy, Musgrave attempted to provide justifications for merit goods applicability in public policy over the next thirty years. That controversy continues to this day, and so it is useful to examine the relevant counter-arguments and developments in the merit goods literature before proceeding with the case study. To do so, I will begin with a more thorough characterization of the concept. I will do this in the context of Musgrave’s most expansive characterization of the concept, his 1987 article in *The New Palgrave: A Dictionary of Economics*.¹⁷ My

¹⁶ Many public finance textbooks report this simple definition. See, e.g., JOSEPH E. STIGLITZ, *ECONOMICS OF THE PUBLIC SECTOR* (2000) and HARVEY S. ROSEN, *PUBLIC FINANCE* (1999).

¹⁷ For Musgrave’s revision, see Richard A. Musgrave, *Merit Goods in RATIONALITY, INDIVIDUALISM AND PUBLIC POLICY* (Geoffrey Brennan and Cliff Walsh eds., 1990). A good

project is framed in the context of *political* theory; this discussion is intended to give us an idea of the development of the merit goods concept so that we may be in a position to understand its applicability to public policy and political theory. Second, the 1987 definition provides the most expansive characterization of the concept. While subsequent writings may be useful for one's personal information, it has less utility as a public policy tool.

In that article, Musgrave outlines six possible explanations for merit goods. First, he emphasizes that merit goods should be sharply distinguished from another economic category, public goods. Second, Musgrave says that interference with consumer preferences might seem to occur in some cases where it is actually valued. An example here might be if we "correct" one's preferences to show him that he really *did* want, say, education. Third, he says that some preferences might be affected by the social setting in which they are exercised — but never so much as to devalue individual choice. Taken together, these three provide inadequate means to characterize the concept. Merit goods explicitly aim to interfere with individuals' preferences. The first three explanations simply attempt to reduce to fit the concept into classical micro-theory.

Indeed, as Musgrave notes, "none of these cases offer[] an appropriate setting in which to apply the merit or demerit concepts."¹⁸ The fourth possibility, however, is one that Musgrave finds much more applicable: "community values as a restraint on individual choice."¹⁹ The fifth possibility considers the case of redistribution, a very narrow case of merit goods; while the sixth examines the possibility of lower and higher (i.e., ethical) preferences. Musgrave says that the fifth and sixth explanations, while cases of merit goods, can still be fit into the consumer sovereignty norm; therefore, Musgrave "would reserve [merit goods'] use for the setting dealt with under (4), but that of (5) and (6) may also have a claim"²⁰ Thus we have Musgrave's broadest characterization of a merit good: to impose community values, for the purpose of redistribution, or to elicit an individual's higher preferences.

As we examine merit goods in this Article, I primarily work from (4) above: the imposition of community preferences. However, there is an

anthology of merit goods literature can be found in WILFRIED VER ECKE, MERIT GOODS: THE BIRTH OF A NEW CONCEPT — THE UNFINISHED ETHICAL REVOLUTION IN ECONOMIC HISTORY (forthcoming 2006).

¹⁸ Richard A. Musgrave, Merit Goods, *In* THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 453 (John Eatwell, et al. eds., 1987).

¹⁹ *Id.*

²⁰ *Id.*

important corollary to (6). Musgrave writes that the merit goods concept may be applied as a means to elicit an individual's *ethical* preferences. However, imposing ethical choices is really an example of the larger case we generally call morality legislation. Taken jointly with the imposition of community values, we can see that the concept of merit goods is, at its strongest, a means by which certain legal rules are imposed to enact value judgments through public policy. My argument is that all characterizations of merit goods, including the first three mentioned by Musgrave above, can be conceptualized as value judgments.

This explains why I consider redistribution a "very narrow case of merit goods." If merit legislation intends to make value judgments through public policy, redistributive policies are certainly merit goods. After all, a social safety net, subsidized prescription drugs for the elderly, and myriad other policies are generally defended on the grounds of some moral or value judgment, something that society "should" do. But while redistributive policy can be justified on merit grounds, it is by no means the only type of values legislation prevalent. Obviously, some cases values legislation might be extreme: for example, an absolute prohibition on abortion. However, others are more subtle — but cases of values legislation nonetheless. As examples, we need look no further than the anecdotes presented at the outset. In these cases, Haddonfield, NJ and Washington, DC decided that there was some value that the community should hold. This community value superceded the right of a citizen to have exclusive domain over the use of his property. This characterization will be important in Part II.

This clarifies the concept so that its definition can more explicitly recognize the moral judgment taking place. Instead of speaking vaguely about appropriate levels of consumption, we can say that *(de)merit goods are those which public authorities, through a value judgment, determine should be consumed higher (lower) than at market rates.*²¹ To achieve this judgment through policy, legal rules interfere with individuals' preferences.

The objection might be raised here that my unique definition somehow contradicts the general understanding of the concept among economists on the subject. There are three replies. First, problems merit goods pose to economic theory require a more expansive definition of the concept. Second, in the words of John G. Head, one of the first commentators on Musgrave's Articles, "Musgrave's own discussion, though extremely interesting and stimulating, is somewhat unclear, and he makes no attempt

²¹ I intend to use the word "consume" in the loosest sense here. Anything from national defense to a more aesthetically pleasing neighborhood to a higher quality of life can be "consumed" as "goods" in the theoretical sense.

to relate the concept to more familiar theories of public policy.²² Thus, a more comprehensive and interdisciplinary approach is needed if merit goods are to be useful in legal theory. Finally, as Musgrave remarked in 1990, the various characterizations of merit goods are “a departure from the conventional premise of consumer choice, but beyond this they are *too divergent to yield a unique definition of the term*.”²³ It will become clear in the following discussion that the concept of merit good has been vague at best. I hope to define the concept here in such a way as to be useful for legal analysis.

b. History of the Concept

As noted earlier, Richard A. Musgrave first introduced the concept of merit good in his 1957 Article, “A Multiple Theory of Budget Determination.” In that Article, Musgrave identified three functions for the government in the economy: “(1) the function of providing for the satisfaction of public wants [what we today call public goods] (2) the function of providing for adjustments in the distribution of income; and (3) the function of contributing to stabilization.”²⁴ Musgrave terms these the Service, Distribution, and Stabilization Branches, respectively.

After creating this typology, Musgrave puzzles over the fact that some policies undertaken by the Distribution Branch “involve programs which are not distributionally neutral, but whose very purpose it is to favor particular groups.”²⁵ Such policies, Musgrave realizes, “introduce[] a new feature for which so far there is no place in our theoretical framework.”²⁶ This was problematic because in such policies, “public policy aims at interference with individual preferences; . . . [w]here *interference with individual preferences is desired*, our schema must be expanded. Such wants — for lack of a better name I refer to as merit wants — may be thought of as provided for in a separate branch.”²⁷ Here Musgrave introduces the defining characteristic of a merit good: interference with individual preferences. However, the development of the concept was far from over.

²² JOHN G. HEAD, PUBLIC GOODS AND PUBLIC WELFARE 215 (1974). Head’s Article sought to relate merit goods to Keynesian and Pigouvian economics; my attempt is to relate merit goods to legal and political theory.

²³ Musgrave, *supra* note 17, at 210 (emphasis mine).

²⁴ Richard A. Musgrave, *A Multiple Theory of Budget Determination*, 17 FINANZARCHIV 333 (1956).

²⁵ *Id.* at 341.

²⁶ *Id.*

²⁷ *Id.* (emphasis mine).

c. The Distinction from Public Goods

At this point it is important to distinguish merit goods from public goods, and further from private goods. After all, it seems that a good which is provided by the government is a simple case of a public good. However, this is not the case; Musgrave takes on this discussion in his textbook, *The Theory of Public Finance*. Using widely accepted definitions of private and public goods, Musgrave explains that private goods are provided for adequately by the market and consumed freely by individuals. A pure private good might be bread: I want it, so I go to the grocery store and buy it at market prices, freely and without coercion of any sort.²⁸ Public goods, on the other hand, are provided collectively, if at all.²⁹ For example, consider a group of neighbors living in a dark alley. Everyone would benefit from a light in the alley, but no single person can afford to buy one. By pooling their money, each contributes and each benefits. In terms of public policy, we can think of national defense. Everyone might desire protection against foreign armies, but none of us can purchase it or provide it on our own. Therefore, public goods are purchased through the political process: it is the state that buys national defense, or public works, or transportation projects. However, with both private and public goods, resources are allocated in such a way that is ultimately in accord with consumer preferences — even if government intervention was necessary to affect the outcome. This is illustrated by the example of national defense: while government had to intervene to provide national defense, it is still something everyone wanted, and as such, is a public good. In other words, there are no “losers” in the process; even if there were, the gains to the winners outweigh the losses to the losers, making the policy efficient by Kaldor-Hicks standards.

But “[a] different type of intervention occurs when public policy aims at an allocation of resources which *deviates* from that reflected by consumer sovereignty.” This deviation, Musgrave says, must be “clearly distinguished” from public goods.³⁰ In the case of a public good, everyone is better off (previously, we had no light in the alley, and now we do). However, in the merit goods case, certain segments of society are explicitly worse off. Take the case of antitrust legislation: although many more people might be made better off than are inconvenienced, the policy cannot

²⁸ Actually this is not quite true; the very conditions that make a market possible involve coercion. See *infra* note 72 and accompanying text. The point here is simply that traditional economic analysis inexplicably takes those impositions as given when claiming there is no *further* interference in the case of private goods.

²⁹ RICHARD A. MUSGRAVE, *THE THEORY OF PUBLIC FINANCE* 8-9 (1959).

³⁰ *Id.* at 9.

be justified as a public good because there are clear “losers” in the process: the wishes of the monopolist are disregarded and she is not compensated for any loss.³¹ Thus when we are in the presence of merit goods, the thing valued as “good” for society does not benefit every individual, perhaps not even on net.³² Consider another one of Musgrave’s examples: regulations relating to smoking. As a demerit good, smoking is considered “bad” for society, so measures are taken to keep consumption below market rates. Over time, the demerit good policies have grown more and more stringent. Warnings on cigarette packs gave way to advertising restrictions. Later still, smoking was banished to certain sections of restaurants and bars. Finally, in some areas today, smoking is prohibited in all public places. And of course the taxes on cigarettes are a direct means by which the state seeks to reduce consumption. With merit (and demerit) goods, not only are some people made worse off but to effect the desired policy outcome, it may be necessary to make them *increasingly* worse off.

With regard to legal rules, distinguishing between public goods and merit goods is very important. While a particular policy may a “public good,” i.e., the good of the so-called public, it may in fact be a *merit* good. It would be a merit good if there are, as exist in so many cases, explicit or implicit value judgments. The tendency of our everyday discourse — and court cases — to obfuscate this important distinction will be discussed at greater length later.

d. Musgrave’s Development of the Concept

In his 1959 textbook, Musgrave provides a more complete explication of the merit goods concept independent of his public finance theory. He begins by noting that there are some goods that people can buy in the private market but are nonetheless provided for publicly. These goods are “considered so meritorious that their satisfaction is provided for through the

³¹ Ver Eecke, *supra* note 17. Ver Eecke gives this example to show the necessity of merit goods reasoning even the purest economic sense.

³² A skeptic might reply that merit goods should be scrapped and that we should espouse only Pareto-optimal policies. But Pareto-optimality is rarely if ever approximated in the real world. *See, e.g.*, Richard A. Posner, *ECONOMIC ANALYSIS OF LAW* 13 (2002). This leaves us with Kaldor-Hicks efficiency. But given how difficult it is to accurately map all costs and benefits, saying that a given policy leaves society better off on net is merely a shibboleth. Take the case of the Fifth Amendment’s privilege against self-incrimination. The rule might be inefficient because it increase costs of adjudication while decreasing accuracy. Of course, it might be efficient because we are all made better off knowing that defendants’ rights are protected. But this is mere supposition, and regardless assumes that utilitarianism is the proper moral calculus. Posner admits as much. *See id.* at 715-16;. Thus, the claim is either wishful thinking or a merit good. *See infra* notes 214 - 222 and accompanying text.

public budget, over and above what is provided for through the market and paid for by private buyers.”³³ Musgrave provides free or reduced school lunches, subsidized low-income housing, and free public education as examples of merit goods. Additionally, Musgrave introduces the concept of “demerit goods,” when satisfaction of particular preferences is prohibited or discouraged through sumptuary taxes (e.g., liquor).³⁴

Musgrave goes on to explain the distinction between public goods and merit goods, saying that while both are provided through the public budget, public goods “fall within the realm of consumer sovereignty,” while merit goods “by [their] very nature, involve interference with consumer preferences.”³⁵ However, Musgrave retreats from this apparently radical position and immediately weakens this new concept.³⁶ First, he says that some merit goods may actually be public goods, that “fall on the border line” between private and public goods. This *appropriationist* definition, as I will call it, attempts to reduce applications of merit goods into the classical economist’s ostensibly exclusive and exhaustive categories of public and private goods. By attempting to categorize merit goods as “public goods in disguise,” so to speak, Musgrave attempts to reduce the number of public policies that cannot fit into the pre-existing theoretical framework. However, I take this to be an untenable position, as I argue later. (Musgrave’s expansion of the concept over time implicitly indicates a similar view on his part.)

Musgrave then provides two other justifications (not definitions) for merit interference with consumer preferences. First, he discusses the case where informed elites are justified in imposing particular decisions upon others. This might be allowed, for example, in the case of education, where the value of education is much more apparent to the enlightened than to the ignorant.³⁷ Since the consumers lack the ability to obtain the knowledge necessary to make an informed decision, Musgrave allows for interference. In the second case, Musgrave argues that consumer sovereignty “rests on the assumption of complete market knowledge.”³⁸ Insofar as the consumer does not have “complete market knowledge” (perfect information), Musgrave sees the possibility of a “distortion in the preference structure that needs to be counteracted.”³⁹

³³ Musgrave, *supra* note 29, at 13.

³⁴ *Id.*

³⁵ *Id.* at 13.

³⁶ This “retreat” is outlined fully in Ver Eecke, *supra* note 17, Part I, the section which extensively comments upon all of Musgrave’s texts as they relate to merit goods.

³⁷ Musgrave, *supra* note 29, at 14.

³⁸ *Id.*

³⁹ *Id.*

These two justifications both deal with different sides of the same coin: imperfect or asymmetrical information. However, Musgrave's attempt to justify merit goods on these grounds is critically flawed. Traditional microeconomic theory is based on the assumption of perfect information. If the theory's assumptions are invalid, then the prescriptive conclusions are, too. Any attempt to justify merit goods on the ground of imperfect information is unnecessary; in such a case, we are in the presence of a market failure, and interference is justified, almost by definition.⁴⁰

Interestingly, both Musgrave and his commentators attempt to justify merit goods on the grounds of *correcting* preferences in the face of imperfect information in this and subsequent passages. Charles E. McClure wrote shortly after Musgrave that merit goods were normatively meaningless. However, in doing so, he was careful to acknowledge that market failures due to imperfect information do exist.⁴¹ Though he claimed that these cases "need not involve interference with individual preferences,"⁴² he does recognize this aspect of the merit goods problem. Musgrave similarly wrote in 1971 that individuals may need guidance, "to permit them to make a more satisfactory (in terms of their *own* preference) decision."⁴³ The thread running through this and similar arguments is simple: "some degree of interference in consumer choice may be desirable . . . [because] the ultimate objective is production in line with individual choice, *rather than imposed values*."⁴⁴ In his new textbook, published soon after the above-quoted Article, Musgrave continues this line of argument, writing that "what appears to be a contradiction may turn out to be a correction for deficiencies in the prevailing exercise of consumer choice."⁴⁵

This attempt at justification suffers from two problems. First, as explained above, it attempts to explain a problem — imperfect information — that does not require merit goods as a solution. But moreover, correction of preferences is not interference in the strict sense. After all, if an individual's preferences are brought into line with his "true" preferences, he

⁴⁰ Stiglitz presents a compelling discussion of the institutional failure of western economic models. Stiglitz, *supra* note 10.

⁴¹ Charles E. McClure, *Merit Wants: A Normatively Empty Box*, 27 FINANZARCHIV 475 (1968).

⁴² *Id.* at 475.

⁴³ Richard A. Musgrave, *Provision for Social Goods in the Market System*, 26 PUB. FIN. 314 (1971).

⁴⁴ *Id.*, emphasis added.

⁴⁵ RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 81 (1973).

should be better off *ex post*; therefore, the transition could not have been coercive and the extent to which it was coercive is compensated for.⁴⁶

Correction of preferences, however, is a subset of a group of justifications that I call *market failure* justifications. These arguments proceed along the lines of traditional arguments in favor of government interference at times of market failure: if free market mechanisms are not working, it is up to the government to correct them. Musgrave gives two market failure justifications: first, to provide consumer information; and second, to allow for externalities.⁴⁷

Finally, Musgrave provides the *redistributive* justification for merit goods. In this case, the government imposes preferences with the intention of providing free or subsidized services to the poor — an example Musgrave has used since his first article.⁴⁸ This justification uses intersubjective utility calculations as a basis for in-kind redistribution, and can be considered Pareto-optimal.⁴⁹

What the appropriationist definition, the market failure justification, and the redistributive justification all have in common is an attempt by Musgrave to reduce the concept of merit goods back into traditional micro-theory. Musgrave says as much when he admits that for these justifications, “the merit-good concept falls within the framework of traditional analysis in which efficient allocation must in the end be related to individual choice.”⁵⁰ The appropriationist, market failure, and the redistributive explanations all fall short of providing the type of justification that is needed for merit goods. However, it should be noted that as early as 1959, Musgrave wrote about the applicability of the concept to sumptuary taxes on alcohol and

⁴⁶ Consider this example: A’s net utility, given preferences p , can simply be represented as U_p . After bringing A’s preferences into accord (albeit forcibly) with his true preferences, let us say p' , A has some new net utility, represented by $U_{p'}$. Insofar as p' represents A’s “true” preferences, it is true that $U_{p'} > U_p$. Insofar as A is a rational actor (given by the assumptions of micro-theory), A will freely choose to move from p to p' — any rational actor will freely choose a path that increases his net utility. The skeptical reader might reply that the example is fraught with problematic assumptions. Touché. See *infra* note 70.

⁴⁷ Musgrave & Musgrave, *supra* note 45, at 81. In considering externalities, Musgrave not only addresses the common cases (such as air pollution emitted from a car) but also psychic externalities (from, say, living in a dirty neighborhood).

⁴⁸ Musgrave, *supra* note 24.

⁴⁹ Musgrave & Musgrave, *supra* note 45, at 81. In an intersubjective utility calculation, redistribution in-kind is defended when donor D receives utility from consumption of a good by recipient R. Since R is not required to consume the good (but is generally better off if he does) and since D receives utility from the transfer (knowing that his money is being spent on, say, housing and not cocaine), the process is Pareto-optimal and justifiable through classical economic theory.

⁵⁰ *Id.*

tobacco. These examples are not cases of public goods (appropriationist), not cases of asymmetrical information (market failure), and not a case of transfer in-kind (redistributive). As such, Musgrave had already provided the foundation for a more expansive definition of merit goods, even though he did not provide an explicitly broader definition for some time.⁵¹

e. An Ideal Concept

An important development in Musgrave's thought about merit goods is illustrated in his 1971 article, "Provision for Social Goods in the Market System." Here, he writes that merit goods "may be either of the private- or social-good type."⁵² At first, this seems to be little more than another attempt to reduce the concept into traditional categories of micro-theory. But in fact Musgrave is referring to clear cases of imposition, noting that we may impose preferences for what are usually considered private goods as well as those we usually consider public goods. Free dental clinics and subsidized housing are examples of goods which individuals may buy on the market but for which consumption may also be imposed. Early American history provides another interesting example. In the city of Philadelphia, Benjamin Franklin founded the country's first fire department. But the provision of fire protection was much different than it is now. At that time, citizens paid Franklin a particular amount for fire protection. A medallion was displayed on the houses that had paid, and if ever there was a fire, Franklin and his men would put it out. But houses without the medallion were not protected.⁵³ In this sense, fire protection was treated as a private good: individuals transacted the good on the free market. Over time, however, we have come to treat fire protection as a merit good: since the market was underproviding protection, the state now provides it for everyone, regardless of ability to pay.

Finally, Musgrave also notes that consumer preferences may be overridden in the case of public goods. For example, although we might all want national defense, we may not necessarily want it at the rates it is being provided. Additionally, this idea can apply to demerit goods as well: tobacco and alcohol, for example, can be consumed on the free market but are also subject to demerit good regulation.⁵⁴

⁵¹ Ver Eecke uses this example to show how the domain of merit goods can be expanded. I will use this same reasoning. *See generally* Ver Eecke, *supra* note 17.

⁵² Musgrave, *supra* note 43, at 313.

⁵³ Personal visit to Philadelphia, PA, 2003.

⁵⁴ Musgrave, *supra* note 43, at 313.

These examples show Musgrave's characterization of the merit goods concept as an *ideal* concept. Ideal concepts are ones that can apply in degree or in part. For example, safety is an ideal concept. A particular city may be more or less safe; it is not just a matter of "all or nothing." Ideal concepts can also coexist simultaneously. Thus a city may be more or less safe and more or less beautiful. Ideal concepts are to be distinguished from "tags" or "boxes" — concepts that apply to concrete objects. For example, an object can be a car or a boat, but generally not both.⁵⁵ By characterizing the merit goods concept as an ideal concept, Musgrave is showing not only that it can apply in degree but also that it can apply coextensively with public goods, private goods, or both.⁵⁶ A perfect example is Musgrave's earlier case of free housing for the poor. Clearly, housing is a private good available on the free market; I can buy a house anytime I want to, subject to normal market forces. However, housing (specifically for the poor) is also a public good, in that all of society presumably benefits from having fewer people on the streets, turning to crime, using drugs, and so on. However, it is at the same time a merit good, since financing Section 8 housing is mandatory for all taxpayers regardless of their preferences.

As I noted earlier, Musgrave first put this idea forth in a 1971 article. This, should be read as a response to the 1968 article by Charles E. McClure, "Merit Wants: A Normatively Empty Box." Musgrave's contention seems to be — and my contention is — that McClure misunderstood merit goods. He found the concept "normatively empty" because he considered it a "box," that is, a matter of all or nothing. Since the concept can be applied in degrees and in conjunction with other concepts — as shown specifically by Ver Eecke — it is much more reasonable to think of merit goods as an ideal concept. Head, who writes that goods with merit aspects also sometimes exhibit public goods aspects, echoes this sentiment.⁵⁷ In fact, Head uses the concept of merit goods to

⁵⁵ Wilfried Ver Eecke has first and most thoroughly explicated the concepts of public, private, and merit goods as ideal concepts. See generally Ver Eecke, *supra* note 10, and specifically 145-46, n.21, & n.22. Ver Eecke has also put the idea forth elsewhere. See Wilfried Ver Eecke, *Public Goods: An Ideal Concept*, 28 J. SOCIO-ECON. 139, 140 ("[T]he three economic concepts of public, private, and merit goods are ideal concepts that can be more or less present in an economic event, [and] an economic event can embody characteristics of more than one ideal concept"). Ver Eecke's characterization of merit goods as an ideal concept is the most explicit and thorough of the authors I am considering here, and I will employ his conception of the "ideal concept" in this paper.

⁵⁶ See Kenneth Godwin, *Charges for Merit Goods: Third World Family Planning*, 11 J. PUB. POL'Y 415 (1991). Ver Eecke uses this article as a prime example to show how birth control may be simultaneously treated as a private good, public good, and merit good, illustrating the ideal concept again. See Ver Eecke, *supra* note 17.

⁵⁷ JOHN G. HEAD, PUBLIC GOODS AND PUBLIC WELFARE 223 (1974).

point out problems in traditional *public* goods theory and shows the potential “cross-over” between the two concepts: assuming a distinction between merit goods and public goods, it is possible to imagine some situations where public goods are provided Pareto-suboptimally and merit goods happen to be provided Pareto-optimally. Thus, while there is a radical *conceptual* difference between the two goods — specifically, merit goods impose values and have clear “losers,” while public goods do not — the nature of the concept allows “publicness” and “meritness” to exist simultaneously, and in varying degrees.⁵⁸

f. Merit Goods: Problematic in Law?

Regardless of the explanation given or the nature of the concept, merit interference posed some political problems to Musgrave. From the very beginning, he worried that “[i]nterference with consumer choice may occur simply because a ruling group considers its particular set of mores superior and wishes to impose it on others. Such determination of wants rests on an authoritarian basis, not permissible in our normative model based upon democratic society.”⁵⁹ Over a decade later, he wrote that “it is evident that a society — be it market or socialist — does interfere with consumer choices and does impose its own preferences to a significant degree.”⁶⁰ In his subsequent textbook, the language is even stronger; Musgrave says “even a democracy such as ours has aspects of an autocratic society, where it is considered proper that the elite, however defined, should impose its preferences.” He further warns that “these considerations can be readily subject to abuse and become the excuse for totalitarian indoctrination.”⁶¹ Yet despite these problems, Musgrave *expanded* the domain of the merit goods concept over the years.

Musgrave and others claim that the merit goods problem is a failure of politics only. By this logic, Musgrave might argue that he expanded the concept because of its necessity, but the coercive element is a political (not an economic) failure. For example, he writes that a certain group of people might, in a democratic society, vote against particular policies — say, a tax increase. However, if they lose the vote, they are nonetheless required to contribute. Musgrave says that “such a violation would not occur if preferences were known [better] . . . this is a defect which would not arise in

⁵⁸ *Id.* at 254-5.

⁵⁹ Musgrave, *supra* note 29, at 14.

⁶⁰ Musgrave, *supra* note 43, at 313.

⁶¹ Musgrave & Musgrave, *supra* note 45, 81.

a more perfect system.”⁶² The contention here is that it is impossible to actually create an economically perfect outcome, and the political mechanism can only offer a rough approximation of actual citizen preferences. While this is true, the fact remains that interference with preferences would exist *even if* the government were in a position to know all the preferences of every citizen perfectly. As evidence of this, we need only look at our earlier example of cigarettes. We know very well that certain individuals experience a disutility as a result of the policies put in place. But instead of revising the policies to reduce the disutility, we revise it to *increase* the disutility: if taxing cigarettes was not enough, we ban smoking in public, and so on.

To illustrate this point, consider the 1984 edition of *Public Finance in Theory and Practice*. After a discussion of the various explanations of merit goods, Musgrave takes on the issue of communal wants. He says that individuals may live in a community that decides to value a particular commodity as “good,” and that individuals are forced to accept those values “by virtue of membership in a group.”⁶³ Thus “[g]enuine merit-good situations based on communal interest do exist.”⁶⁴ And they exist because the community has chosen to impose its values on its membership, *even in* the face of perfect information. Haddonfield and Washington are again perfect examples. It is true that ordinances in both of these municipalities limit their citizens’ freedom — but membership in these respective communities requires acceptance of these aesthetic values “by virtue of membership in [the] group.”⁶⁵

g. The Contribution of Political Theory

The concept of merit goods has posed a problem to all of economic theory from the beginning and continues to do so to this day. However, after weakening the concept, attempting to squeeze it into neoliberal

⁶² RICHARD A. MUSGRAVE & PEGGY MUSGRAVE, *PUBLIC FINANCE IN THEORY AND PRACTICE* 79 (1984).

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ Some argue that where people live is itself an expression of preference. Thus, by “voting with their feet,” citizens can purchase the optimal bundle of community values, so that even values imposed by virtue of group membership are actually the function of individual choice. See, e.g., Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 614 (1956). But this rather sanguine view fails to account for the fact that quite a large number of people lack the resources to “vote with their feet.” Bringing reality into line with Tiebout’s theory would require income redistribution, but the economic model takes distribution as given in its analysis and cannot opine as to the desirability of a particular distribution. See, e.g., Richard A. Posner, *ECONOMIC ANALYSIS OF LAW* 14-15 (2002).

economic theory, and finally allowing a small space for the concept, Musgrave made a suggestion to the economic profession: to give up.

Essentially, Musgrave argued from 1959 onwards that the merit goods problem was not an exclusively economic problem (like, say, that of public goods or even redistributive tax policy). He first made the claim very tentatively, saying that the general problem of merit goods posed difficulties for economic theory, so “[t]hus it is proper for the economist to concentrate on the problem of social wants [i.e., public goods].”⁶⁶ In another version of the same book, he wrote that the problem posed by public goods or even by mixed goods is “more amenable to economic analysis” than that posed by merit goods.⁶⁷ Finally, in the 1984 version of the textbook, Musgrave writes that merit goods are “inconvenient to conventional efficiency analysis . . . [and] not covered by the traditional analysis of [collectively provided] goods.”⁶⁸

Musgrave repeatedly says merit goods analysis is outside of economic theory, and yet the concept is theoretically necessary given the value judgments in economic and legal policy. One way to proceed from here is to undertake a critical evaluation of economic theory and examine how the theoretical framework — from which policy prescriptions are derived — must be expanded for merit goods to fit in with public and private goods. This is one useful aspect of McClure’s 1968 Article. When he considered merit goods “normatively empty,” he was working within narrow bounds, arguing that merit goods contradict Musgrave’s three-branch system. However, this objection is not particularly relevant. This article is about merit goods, not Musgrave’s tripartite scheme; a contradiction with the scheme need not invalidate the concept. Indeed, one can imagine McClure accepting the validity of merit goods if we divorce it from Musgrave’s system (as Musgrave himself does after 1959). Secondly, McClure writes that the concept “has no place in a normative theory of the public household based upon individual preferences.”⁶⁹ However, while he takes this to imply a rejection of the merit goods concept, the statement could also be taken to imply a rejection of the underlying “normative theory . . . based upon individual preferences.” Though this is an interesting intellectual exercise, it is not the goal of my study.⁷⁰

⁶⁶ Musgrave, *supra* note 29, at 89.

⁶⁷ RICHARD A. MUSGRAVE, *THE THEORY OF PUBLIC FINANCE* 89 (1959) (Musgrave at Harvard).

⁶⁸ Musgrave & Musgrave, *supra* note 62, at 79.

⁶⁹ McClure, *supra* note 41, at 482.

⁷⁰ For a thorough critique of the assumptions underlying economic theory — and in particular the rational actor model — see Jon Hanson & David Yosifon, *The Situational Character: A Critical Realist Perspective on the Human Animal*, 93 *GEO. L.J.* 1 (2004); Jon

The second way to proceed would be to recognize that merit goods are inherently interdisciplinary. Musgrave has already opened the possibility to treating merit goods in public policy; after all, he recognizes that political mechanisms are those by which all policies, including economic policies, are implemented. Additionally, Musgrave discusses merit goods in the context of distributional justice and categorical equity.⁷¹ Viewed this way, one can see an appeal to philosophical traditions (Head even makes reference to Aristotelian *akrasia*), because such interference is compelled by the theory. Similarly, debates about the type of redistributive policy worth having and whether certain commodities should be distributed through non-market mechanisms — what Calabresi calls the inalienability rule — hinge inexorably on ethical, merit goods decisions.

Ver Eecke emphasizes the interdisciplinary nature of merit goods in his 1998 Article. Drawing on Kantian metaphysics, he defends merit goods as the requisite possibility conditions for the operation of the free market. This is an interesting argument not only because it synthesizes economic and philosophical traditions but also because it presents prescriptions for *limits* on merit goods, potentially assuaging the fears of Musgrave and the like.⁷² That is, interferences might be justified to enable a fairly-functioning market. But interferences would *not* be justified if they exceeded this bound.⁷³ Additionally, he defends truth in advertising laws as provisions that arise out of “epistemologically justifiable conflicts” between individuals and supra-individual entities.⁷⁴ Similarly, Hegel considers property acquisition through market mechanisms to be a necessity for realization of freedom.⁷⁵ Thus, it is clear that the concept of merit goods can be strongly linked to philosophical traditions.

Taken together, these possibilities place the merit goods question in the realm of philosophy. Given that any policy will be implemented through law and politics, and that the system is informed by its philosophical underpinnings, this seems reasonable and is the approach I use here. But in addition to being a justification for this study, the preceding discussion is

Hanson & David Yosifon, *The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture*, 152 U. PA. L.REV. 129 (2003).

⁷¹ Musgrave & Musgrave, *supra* note 62, at 98.

⁷² Ver Eecke, *supra* note 10, at 138-40.

⁷³ This should not be taken to imply that there are no value judgments required after the initial interference. After all, determining *what* exactly constitutes a fair market is itself the subject of debate.

⁷⁴ Ver Eecke, *supra* note 10, at n.17.

⁷⁵ Ver Eecke, *supra* note 10, at n.8. *See also* Georg William Frederic Hegel, *PHILOSOPHY OF RIGHT* 38 - 57 (T. Knox trans., Clarendon Press 1942) (1821).

important because it emphasizes the increasing problem of economics to deal with the problems raised by its own discipline.

h. Conclusion

This section has introduced the merit goods concept, distinguished it sharply from public goods, and examined various theoretical discussions of the topic. On face, this may have seemed rather disconnected from the initial problem: one of legal theory. However, merit goods raise issues that economics (by the admission of economists themselves) cannot adequately deal with. Moreover, merit goods arguments may be linked to the Aristotelian, Kantian, and Hegelian traditions. Political theory might loosely be defined as the intersection of philosophical thought with our political and legal reality. Given that economic decisions are effected through political and legal mechanisms, merit goods uniquely apply to law and politics.

To adequately “ground” the discussion of merit goods, I now proceed with a case study in Constitutional law and show how the merit goods concept can be applied in takings cases. The regulations at issue aim, in general, at limiting how an individual may use his property. Thus they restrict one of the most fundamental economic rights, private property. My goal is to show how merit goods can be applied in this context, and then to move from the case study to constitutional democracy in general.

But the connection runs deeper. If the discussion above shows certain limitations to classical economic theory, then it is facially inappropriate to use that theory as the foundation for another discipline. Legal and political theorists who rely on market mechanisms to create political outcomes must then suffer the same limitations as the economist. I therefore show the limitations of these theories, the unique applicability of merit goods, and the advantages of including the new concept. As Head writes, “It is one thing to settle the problem of interpreting the merit goods concept. It is, of course, quite another to show that the concept, once defined, has a legitimate place in a normative theory of public policy.”⁷⁶ This is the aim of the rest of the Article.

III. Private Property and Its Limits

Part II outlined the development of the merit goods argument to illustrate a shortcoming in contemporary economic theory. However, the

⁷⁶ Head, *supra* note 57, at 256.

problem I framed in the introduction was in the context of law. Specifically, certain legal economists and democratic theorists place a high value on individuals' right to choose. These authors are strongly influenced by free-market economics and place a high value on preserving the inviolability of individuals' preferences. Indeed, in unambiguous terms, they use utility maximization as explicitly legal and political end.

The aim of this Article is to provide a theoretical justification of *interference* with individual preferences and shed light on the value judgments implicit in *all* policies. In doing so, I refute the claims of theorists such as Nozick, Hayek, and others, who ascribe to the individualistic, market-based view, alluded to above. To transition from economic theory to political theory, I analyze an aspect of constitutional law, regulatory takings. To the libertarian, the right to private property is paramount. In 1690, John Locke wrote that

the supreme power [could] not take from any man *any part* of his property without his own consent. For the preservation of property being the end of government . . . it necessarily supposes and requires that the people should have property.⁷⁷

Ever since that time, private property has been one of the fundamental rights that right-liberals have held to be sacrosanct. Earlier, I claimed that American political reality is strongly influenced by libertarianism and right-liberalism.⁷⁸ Therefore, it would seem reasonable to expect property rights to be fundamental in our political system. In this section, I examine this claim, specifically as it relates to the merit goods argument. In the first section, I defined merit goods as those goods which public authorities, through a value judgment, determine should be consumed higher than at market rates. At the most intuitive level, it is possible to see how private property might be limited because something — e.g., clean air, open space, a sense of community — was being “consumed” at rates that were decidedly too low.

But do the principles on which the American political system is based support such interference with the right to private property? At first glance, it seems so. The United States Constitution says that:

⁷⁷ JOHN LOCKE, SECOND TREATISE ON GOVERNMENT 77 (Prometheus Books, 1986) (emphasis added).

⁷⁸ See *supra* note 6 - 7 and accompanying text.

No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.⁷⁹

The last part of the Fifth Amendment is the so-called “takings clause.” Additionally, the right to private property is protected under the Fourteenth Amendment’s “due process clause,” which states that

No State shall . . . deprive any person of life, liberty, or property, without due process of law.⁸⁰

On face, the prescription seems rather straightforward. Private property is protected under the Fifth Amendment: for the state to take my property for public use, it must provide “just compensation.” This is made applicable to the states through the Fourteenth Amendment, which guarantees “due process of law” in any takings cases.⁸¹ But what exactly is “just compensation”? And what about cases where the value of property is reduced? Reduced to zero? Locke’s claim seems to be that private property cannot be taken for public use even *with* compensation — nothing short of explicit consent can make the transfer legitimate. But perhaps most important, there is a larger theoretical question: how do such policies situate themselves against right-liberals’ claims that private property should be protected unconditionally?

a. Overview

In this section, I examine a variety of U.S. Supreme Court cases in the realm of regulatory takings.⁸² In these instances, the owner’s property is not “taken” in the literal sense; that is, the property has not been appropriated, in whole or in part, by the state. Instead, government regulations cause the owner’s property to be limited in use, diminish in value, or otherwise be restricted. Analyzing the Supreme Court’s interpretation of the Fifth Amendment’s taking clause shows that property rights have not been held to be absolute, as right-liberalism would dictate. This sets up the theoretical discussion for the next section.

⁷⁹ U.S. CONST., amdt. V (emphasis added).

⁸⁰ U.S. CONST., amdt. XIV (emphasis added).

⁸¹ Chicago, B. & Q. R. Co. v. Chicago, 166 U.S. 226, 239 (1897).

⁸² I am not considering instances of physical invasion of property or cases where people are stripped of their property because they commit a crime or because of bankruptcy (takings that Nozick calls “rectification of injustice”).

At this point, the importance of merit goods is clear. If the concept shows a weakness in economic theory, it similarly shows a weakness in the strands of legal economics that adopt utility maximization as the goal for *legal* rules. Furthermore, the restrictions on property the Court approves are particularly telling. If interference with private property is justified, then interference with second-order rights (to adopt Nozickian language) is similarly justified. In other words, libertarian legal theory would not be “failing at the margins,” as it were; rather, the very basic assumptions and axioms of the system would be necessarily flawed.⁸³

In this section, I examine five Supreme Court cases to illustrate the Court’s relatively narrow interpretation of the takings and due process clauses. I start with *Mugler v. Kansas* (1887), where the value of Mugler’s property, a brewery, was diminished 75% by a prohibition on the sale or manufacture of alcoholic beverages. However, the Court refused to declare the reduction in value a “taking;” instead, it upheld the restriction.

The Court’s precedent in *Mugler* stood for thirty-five years. However, in *Pennsylvania Coal Company v. Mahon* (1922), the Court recognized, for the first time, a “regulatory taking.” In this case, the owner of property was owed just compensation even when his property was not physically appropriated. This was a movement away from the position put forth in *Mugler*. However, the defense of property rights was not as broad as might be immediately thought. In *Euclid v. Ambler* (1926), regulations limiting the use of one’s land (and as a result, the profit one could derive from that land) were upheld. The fourth case reinforces this. In *Penn Central Transportation Co. v. New York* (1978), the Penn Central Transportation Company wanted to erect office buildings over Grand Central Station, but was prevented from doing so because of the station’s designation as a historical landmark. The Court upheld the constitutionality of such laws even though they restricted the uses of private property. Finally, I examine *Lucas v. South Carolina Coastal Council* (1992) and *Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency* (2002). These cases illustrate some contemporary developments in the Court’s position toward limits on the use of private property as related to zoning laws.

In discussing each of these cases, I present background about the case and the court’s decision, after which I examine the relevance of the particular case to merit goods and the issue of value judgments in legal

⁸³ It is interesting to note that I will paint the case for *interference* with private property rights in terms of merit goods. Ver Eecke shows how private property can be *justified* on merit goods grounds. See Ver Eecke, *supra* note 10, at 138-40. The dynamic between these positions shows that both positions have their limits and can be coextensive. This furthers the characterization of merit goods as an ideal concept. See *supra* note 55.

rules. However, I would like to note that the purpose of this section is not to review takings case law as it relates to land use, due process, eminent domain, or the police powers. Moreover, there are many cases that deal with regulatory takings that I am not including in my discussion here.⁸⁴ Of course, I will touch on all of these topics, since they are relevant to the discussion at hand. But my methodology will differ from most legal scholars' in that I focus almost exclusively on (1) the most significant cases that deal with takings of private property and (2) those aspects of the cases that are related to the merit goods argument. I thus present a close textual analysis of Supreme Court cases to illustrate examples of (implicit) merit goods reasoning. The implications will be explored in the next section.

b. *Mugler v. Kansas*

The first major court case relevant to the discussion at hand is *Mugler v. Kansas*.⁸⁵ The plaintiff, Mugler, operated a brewery in Saline County, Kansas. But in 1880, Kansas amended its constitution to declare that “any person or persons who shall manufacture, sell, or barter any spirituous, malt, vinous, fermented, or other intoxicating liquors shall be guilty of a misdemeanor.” Mugler had been operating a brewery for several years before the passage of the amendment.⁸⁶

Mugler appealed, claiming the Kansas Constitution conflicted with the due process clause of the Fourteenth Amendment. At the outset, the Court rejected the claim: “legislation by a State prohibiting the manufacture within her limits of intoxicating liquors, to be there sold or bartered for general use as a beverage, does not necessarily infringe any right, privilege, or immunity secured by the Constitution of the United States.”⁸⁷ The Court elaborated:

[n]or can it be said that government interferes with or impairs any one's constitutional rights of liberty or of property, when it determines that the manufacture and sale of intoxicating drinks, for general or individual use, as a beverage are, or may become, hurtful to society, and constitute, therefore, a business in which no one may lawfully engage.⁸⁸

⁸⁴ For a good discussion of a broad range of regulatory takings cases, see WILLIAM A. FISCHER, *REGULATORY TAKINGS: LAW, ECONOMICS, AND POLITICS* (1995).

⁸⁵ 123 U.S. 623 (1887).

⁸⁶ *Id.* at 656.

⁸⁷ *Id.* at 657.

⁸⁸ *Id.* at 662.

There are several important aspects to the holding. First, the laws in question do not interfere with one's constitutional rights. In other words, the Court is saying that though individuals' preferences might be restricted, such interferences are constitutionally legitimate. Additionally, Mugler contended that individual, private consumption of intoxicating beverages was not injurious to the public. The Court disagreed, saying that even individual use was hurtful. Finally, it could be the case that the restricted behavior is not presently harmful to society. Still, if the action "may become" hurtful at some (indeterminate) point in the future, the Court said that the restriction is legitimate.⁸⁹

The Court then considered the economic argument. Mugler's brewery was opened when it was legal to produce alcoholic beverages and had a high land value at the time; the factories were built specifically to produce beer. The plaintiff contended that prohibiting the buildings from being used for the intended purpose "is, in effect, a taking of [f] property for public use without compensation and depriving the citizen of his property without due process of law."⁹⁰ Mugler claimed that his property value fell from \$10,000 to approximately \$2,500, and for that reason, he deserved compensation for his loss.

The Court rejected the argument, saying such an "interpretation of the Fourteenth Amendment is inadmissible. It cannot be supposed that the states intended, by adopting that Amendment, to impose restraints upon the exercise of their powers for the protection of the safety, health, or morals of the community."⁹¹ The Justices repeat this later, saying that "a prohibition simply upon the use of property for purposes that are declared, by valid legislations, to be injurious to the health, morals, or safety of the community, *cannot, in any sense, be deemed a taking or an appropriation of property for the public benefit.*"⁹² They go on to say that when the state deems such a limitation necessary (involving merit goods reasoning), it "cannot be burdened with the condition that the State must compensate such individual owners for pecuniary losses they may sustain." This proviso holds even if the legislation was passed *ex post*, even if the proprietor was using his property lawfully before the law was passed.⁹³

There is a point I would like to make about the police power, namely, governmental interference in the name of public safety, health, welfare or

⁸⁹ *Id.*

⁹⁰ *Id.* at 664.

⁹¹ *Id.*

⁹² *Id.* at 668-9 (emphasis mine).

⁹³ *Id.* at 669.

morals. Merit goods are those which public authorities, through a value judgment, determine should be consumed at higher than market rates. In *Mugler*, the Court is characterizing the police powers essentially the same way: when “the market” provides public safety, health, or morals at levels that are too low, the state has the authority to interfere and raise consumption to an appropriate level. Such interference is, by definition, a merit good interference. In defending the position, the Court cites *Stone v. Mississippi*, which uses even stronger language, saying that interfering in the interest of public morals is *required* of the government:

No legislature can bargain away the public health or the public morals. The people themselves cannot do it, much less their servants. . . . Government is organized with a view to their preservation, and cannot divest itself of the power to provide for them.”⁹⁴

Thus while many things can be transacted in market terms, public morals are not among them.⁹⁵

The most important effect of the *Mugler* decision was the “all-or-nothing” standard of evaluating regulatory takings. The court wrote that the state “cannot be burdened” with compensating owners for losses in property value when the law limits what they can do with their land. In other words, there was to be only one question in cases like these: was there a physical taking or not? Issues regarding present or future economic value did not even enter the discussion. This precedent stood for thirty-five years.

c. *Pennsylvania Coal Company v. Mahon*

Pennsylvania Coal Company v. Mahon (1922)⁹⁶ was the first case to recognize a “regulatory taking.” This is in contrast to *Mugler*, where the Court refused to consider whether compensation was due, saying that protection of the public welfare and public morals was part of the normal course of duties of a state.

⁹⁴ 101 U.S. 814, 816 (1879).

⁹⁵ This is effectively inalienability rule protection for public morals. See Guido Calabresi & Douglas Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1111-1115 (1972). Note that while Calabresi and Melamed defend inalienability rules on efficiency grounds, deciding that some things may not be transacted at all inherently requires a value judgment.

⁹⁶ 260 U.S. 393 (1922).

In *Mahon*, the Pennsylvania Coal Company (PCC) sold the surface rights to a parcel of land to Mahon's ancestors but explicitly retained full rights to mine the coal in the land below Mahon's property. But an act passed by the state of Pennsylvania on May 27, 1921 prohibited "the mining of anthracite coal in such way as to cause the subsidence of . . . any structure used as a human habitation." As such, the statute effectively destroyed all "existing rights of property and contract." This much was not in dispute; the question was whether such regulation was legitimate under the scope of the police powers.⁹⁷

The Court first explains how and why regulation that limits property value does not necessarily warrant compensation: "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law."⁹⁸ However, for the first time, the Court makes overtures toward recognizing the right of the property holder in light of regulation. The Court says that the restrictions on private property must themselves have limits, "or the contract and due process clauses are gone."⁹⁹

In determining these limits, the Court engages in what can be roughly analogized to an economic cost-benefit analysis. They recognize the public interest in prohibiting PCC from mining coal. However, they say that the "extent of public interest is shown by the statute to be limited," while "the extent of the taking is great."¹⁰⁰ In *Mugler*, the Court wrote that the state cannot be burdened with compensating landowners for pecuniary losses. However, in *Mahon*, they say, "To make it commercially impracticable to mine certain coal has very nearly the same effect for constitutional purposes as appropriating or destroying it."¹⁰¹ This formulation is very important. The ability to mine coal is, of course, the ability to generate a profit. Therefore, the Court is recognizing that when property value is significantly reduced — in this case effectively to zero, since mining was prohibited by the act — compensation is owed.

With this formulation outlined, Court Holmes, who delivered the opinion of the Court, established the now well-known rule that influences regulatory takings case law to this day: "while property may be regulated to

⁹⁷ *Id.* at 412-3. Note that an application of the police powers is implicitly a merit goods justification.

⁹⁸ *Id.* at 413.

⁹⁹ *Id.*

¹⁰⁰ *Id.* at 414.

¹⁰¹ *Id.* The focus on rights to contract and property are typical of *Lochner*-era cases. *Cf.* *Lochner v. New York*, 198 U.S. 45 (1905).

a certain extent, if regulation goes too far it will be recognized as a taking.”¹⁰²

The Court’s decision in the *Mahon* case is rather brief, delivered in just a few pages. But a very important precedent was established: economic factors such as reductions in land value *could* be taken into account when determining whether a taking had occurred, and physical appropriation was not necessary for a taking. This position seems, on face, to cut against the position established earlier, that an implicit merit goods argument could be used as a justification to limit property rights. But as I argue later, the Court’s apparent vacillations on the subject of regulatory takings all fit into an overall schematic, one illuminated by reference to merit goods.

d. *Euclid v. Ambler*

In *Euclid v. Ambler*,¹⁰³ Ambler Realty Company brought suit against the Village of Euclid in Ohio, contending that building restrictions — limiting Ambler’s land to residential uses only — reduced property value, depriving Ambler of liberty and property without due process of law. Interestingly, Ambler argued that the restrictions were a violation of due process, not an outright takings. The standard established in *Mahon* said that regulation that “goes to far” must compensate property owners. Presumably, Ambler considered the primary (or at least strongest) argument to turn on process, not lost economic value.¹⁰⁴

At the outset, the Court seems to favor a traditional, economic cost-benefit analysis. The decision notes that Ambler’s property had a value of approximately \$10,000 per acre before the regulation, but after the regulation, the land was worth only \$2,500 per acre.¹⁰⁵ The question posed to the court was whether the “the ordinance is invalid in that it violates the constitutional protection ‘to the right of property in the appellee by attempted regulations under the guise of the police power, which are unreasonable and confiscatory?’”¹⁰⁶

The court’s answer reinforces the *Mugler* standard. The laws in question, the Court wrote, were necessary, for “with the great increase and concentration of population, problems have developed, and constantly are developing, which require, and will continue to require, additional restrictions in respect of the use and occupation of private lands in urban

¹⁰² *Mahon*, 260 U.S. at 415.

¹⁰³ 272 U.S. 365 (1926).

¹⁰⁴ It is worth noting that, nonetheless, *Euclid* has been interpreted as a takings case.

¹⁰⁵ *Id.* at 384.

¹⁰⁶ *Id.* at 386

communities.”¹⁰⁷ Even here, the Court seems to be making a standard economic public goods argument: if the net benefits of land use regulation were greater than the costs, the regulation could be justified. But the Court goes farther, saying the law “and all similar laws and regulations must find their justification in some aspect of the police power, asserted for the public welfare;”¹⁰⁸ the “exclusion of [certain] buildings . . . bears a rational relation to the health and safety of the community.”¹⁰⁹

As the *Mugler* discussion showed, references to the police powers generally, and public morals and welfare specifically, are implicit merit goods arguments. The Court reinforces this by citing *State v. City of New Orleans*, in which the Louisiana Supreme Court upheld land use regulations on grounds “*aside* from considerations of economic administration.”¹¹⁰ Moreover, when “the exclusion is in general terms of all industrial establishments, . . . it may thereby happen that not only offensive or dangerous industries will be excluded, but those which are neither offensive nor dangerous will share the same fate.”¹¹¹ This is a curious passage. If the right to private property is paramount, it seems that the Court would take all possible measures to prevent any infringement thereupon, and an economic calculus seems reasonable. Moreover, one would think that the Court should take particular pains to ensure that “those which are neither offensive nor dangerous” *don't* share the same fate as those which are. Indeed, a policy is Pareto-optimal if and only if no one is made worse off. That is obviously not the case here.¹¹² Thus the Court is not only declaring the violability of the right to private property but also eschewing economic arguments in defense of private property. This, of course, coincides with our discussion of merit goods — framed as an economic problem outside of the scope of economics — from the previous section. Merit goods reasoning is, quite simply, an unavoidable part of constitutional law.

In short, the Court chose a justification that necessarily predicates itself on a value judgment. Considering the “morals” of a community by invoking the police powers, the Court declared in *Euclid* that a certain type of buildings could be “a mere parasite,” that would destroy the “character of the neighborhood and its desirability.”¹¹³ Such variable and subjective

¹⁰⁷ *Id.* at 386-7.

¹⁰⁸ *Id.* at 387.

¹⁰⁹ *Id.* at 391.

¹¹⁰ 154 La. 271, 283 (1923) (emphasis added).

¹¹¹ *Euclid*, 272 U.S. at 388.

¹¹² Is the outcome defensible on Kaldor-Hicks grounds? Perhaps, but this is unknowable. People might be better off on net when non-offensive buildings are prohibited, but there may be a net loss at well. Again, Kaldor-Hicks efficiency is misleading, a shibboleth, or both.

¹¹³ *Euclid*, 272 U.S. at 395.

quality-of-life concerns are beyond the scope of traditional cost-benefit analysis — which the court explicitly avoided — and are patently unacceptable to a libertarian who considers any diminution in value of one's property to be a taking. Instead of adhering to such arguments, however, the Court chose to invoke what amounts to a merit goods argument. Deciding that market forces would push the quality of life in the Village of Euclid below acceptable levels, the Court upheld land use restrictions.

e. *Pennsylvania Central Transportation Company v. New York City*

One of the most famous takings cases is the *Penn Central* case of 1978.¹¹⁴ The court was deciding whether New York City's Landmarks Preservation Law, which placed restrictions on historic landmarks, was a "taking" of property in violation of the Fifth and Fourteenth Amendments.¹¹⁵ Cognizant of the *Mahon* standard, the Court noted that the law sought "to ensure the owners of any such properties . . . a 'reasonable return' on their investments."¹¹⁶ However, the law placed two rather significant burdens on the owners of historical properties. First, they were charged with keeping the exterior of the building "in good repair;" second, they were required to seek approval for any proposed exterior architectural modifications.¹¹⁷

In 1968, Penn Central sought to build a multistory office building above Grand Central Terminal. Two separate plans for the office building were submitted for approval to the Commission, but both plans were rejected.¹¹⁸ Among the reasons the Commission gave for the rejection were "the dramatic view of the Terminal," and a need to preserve "the majestic approach from the south" of the Terminal. The plans to build a 55-story office tower over the French Beaux-Arts Terminal were, in the opinion of the Commission, "nothing more than an aesthetic joke."¹¹⁹

In response to the rejection, Penn Central filed suit,

claiming, *inter alia*, that the application of the Landmarks Preservation Law had "taken" their property without just

¹¹⁴ 438 U.S. 104 (1978).

¹¹⁵ *Id.* at 107.

¹¹⁶ *Id.* at 110.

¹¹⁷ There are several more nuances to the statute, including transferability of development rights and different provisions for non-profit organizations, but they are not of interest to us here. For a further discussion, see *Id.* at 110-6, especially n.13 and n.14.

¹¹⁸ *Id.* at 116-7.

¹¹⁹ *Id.* at 117.

compensation in violation of the Fifth and Fourteenth Amendments and arbitrarily deprived them of their property without due process of law in violation of the Fourteenth Amendment.¹²⁰

Though the trial court granted injunctive and declaratory relief, but the decision was reversed on appeal; the court said the regulations were necessary and in the public interest.¹²¹ Interestingly, the court rejected Penn Central's claim that the costs of compliance with the law were greater than revenue derived from tenants and concessionaries. This further reinforces courts' unwillingness to allow questions of constitutionality to turn on cost-benefit analyses: even when the constitutional question deals with something as fundamentally economic as private property. In sum, the Appellate Division held that "all appellants had succeeded in showing was that they had been deprived of the property's most profitable use[;] . . . this showing did not establish that appellants had been unconstitutionally deprived of their property."¹²² Thus profitability, while an important aspect of any investment in land, was not a Constitutional guarantee.

The New York Court of Appeals affirmed the lower court's decision, saying that "There could be no 'taking' since the law had not transferred control of the property to the city, but only restricted appellants' exploitation of it."¹²³ This holding was valid "even if the Terminal proper could never operate at a reasonable profit," since Penn Central owned other properties in the area that did operate at a profit.¹²⁴

The Supreme Court emphasized when "a state tribunal reasonably concluded that 'the health, safety, morals, or general welfare' would be promoted by prohibiting particular contemplated uses of land," the regulations have been upheld. Moreover, takings challenges have been rejected even when the laws "caused substantial individualized harm."¹²⁵ In other words, while property need not be physically transferred to constitute a taking, the scope of takings cases not so constituted is very narrow.

Those who hold private property to be sacrosanct claim that protection of such rights should be highest priority of the state. The Court rejects this position as fundamentally unfeasible. Penn Central's claim, the Justices

¹²⁰ *Id.* at 119.

¹²¹ *Id.* at 119.

¹²² *Id.* at 120.

¹²³ *Id.* at 121.

¹²⁴ *Id.* It should be noted that the Supreme Court differed from the New York court, saying that they "do not embrace the position that a 'taking' can never occur unless government has transferred physical control over a portion of a parcel." (*Id.* at 123 n.25). This continues the reasoning established in *Mahon*.

¹²⁵ *Id.* at 125.

argue, would require any property declared a landmark to be a taking. Such an argument would “invalidate not just New York City’s law, but all comparable landmark legislation in the Nation. We find no merit in it.”¹²⁶

To some, preserving historical sites stems from a very explicit value judgment. The Court rejects endorses such valued judgments: “equally without merit is the related argument that the decision to designate a structure as a landmark ‘is inevitably arbitrary or at least subjective, because it is basically a matter of taste.’”¹²⁷ In other words, even “matters of taste” are enough to restrict the rights of some for the benefit of others. Of course, when there are clear winners and losers like this, the policy cannot be defended as Pareto-optimal. This further highlights the relationship between the economic and the ethical aspects of the decision. An ethical decision, by definition, necessarily involves judgment of right and wrong, good and bad. In doing so, some people are made worse off, and the policy must be Pareto-suboptimal. The Court’s words show a movement away from economically-informed decision making and toward ethically-informed decision making:

It is, of course, true that the Landmarks Law has a more severe impact on some landowners than on others, but that in itself does not mean that the law effects a “taking.” Legislation designed to promote the general welfare commonly burdens some more than others.¹²⁸

Speaking in the theoretical terms laid out earlier, a policy designed to “burden some more than others” is, of course, a merit good.¹²⁹

For these reasons, the Court ruled against Penn Central. Just as in *Euclid v. Ambler*, the Court held that neither a reduction in value nor a restriction upon use constituted a taking or a violation of due process. It is important to note that the *Penn Central* case does not involve a case where legislation “goes too far” and thus requires compensation, as prescribed by *Mahon*. Instead, while eschewing any “set formula,” the Court preferred to “engage in . . . essentially *ad hoc*, factual inquiries.”¹³⁰ Moreover, while the Court held that a taking had not occurred in *Penn Central*, they did consider economic factors in the decision. In this case, other factors outweighed the

¹²⁶ *Id.* at 131.

¹²⁷ *Id.* at 132.

¹²⁸ *Id.* at 133.

¹²⁹ The reply might be that this is Kaldor-Hicks efficient, but this is a problematic argument.

See *supra* note 112.

¹³⁰ *Id.* at 104.

purely economic considerations, thus merit goods reasoning. However, the door was left open to future decisions based on economic reasoning.¹³¹

f. *Lucas v. South Carolina Coastal Council*

In *Lucas v. South Carolina Coastal Council* (1992),¹³² a developer purchased two lots on a South Carolina barrier island in 1986. These lots were zoned for single-family residential construction. In 1988, however, the state enacted a law, the Beachfront Management Act (BMA), which effectively barred the developer's plans to erect any permanent habitable structures on his lots.¹³³ The trial court held that this act rendered Lucas's land "valueless." The State Supreme Court, however, reversed, saying that the regulation was designed "to prevent serious public harm."¹³⁴

A 1990 law amending the BMA raised an additional issue. The law had provisions that would allow Lucas to potentially develop his land in economically viable ways in the future. Thus the Court had to decide whether this was a temporary or a permanent taking. The Court ruled that since the law's regulation was *intended* to be permanent, and was permanent at the time of the lawsuit, the case would be treated as a permanent taking.¹³⁵

In their decision, the Court invoked Justice Holmes's reasoning from *Mahon*, saying that for the protection against physical appropriation to be meaningful, it must necessarily protect against egregious reductions in value by regulation as well. Since *Penn Central*, the Court had chosen to engage in "*ad hoc*, factual inquiries" instead of developing a set formula. Thus, in this case, the Court had to rely on the facts of the case rather than a pre-established formula for determining whether this was a regulatory taking.

The Court recognized the various ways in which the government could limit private property: by invoking the police powers, to adjust the benefits and burdens of economic life, or to secure an average reciprocity of advantage to those involved.¹³⁶ However, they worried that regulations

¹³¹ The economic considerations were derived from (1) the economic impact of the regulation; (2) distinct investment-backed expectations; and (3) the character of the governmental action. *Id.* at 104, 124.

¹³² 505 U.S. 1003 (1992).

¹³³ *Id.* at 1006.

¹³⁴ *Id.* at 1010, citations omitted.

¹³⁵ *Id.* at 1011-12.

¹³⁶ *Id.* at 1017. An "average reciprocity of advantage" can be construed as a merit good. A Pareto-optimal solution has to make *no one* worse-off. Any appeal to average utility dispersed over many individuals involves merit goods reasoning, since some people will be

such as the BMA carried “a heightened risk that private property is being pressed into some form of public service under the guise of mitigating serious public harm” when such harm does not exist.¹³⁷ Thus, they write that

there are good reasons for our frequently expressed belief that when the owner of real property has been called upon to sacrifice *all* economically beneficial uses in the name of the common good, that is, to leave his property economically idle, he has suffered a taking.¹³⁸

In putting forth this position, the Court references some of its earlier decisions. As far back as *Mugler*, it was established that the government could limit “harmful or noxious uses” of property. But these words, the Court write, were “simply the progenitor of our more contemporary statements that land use regulation does not effect a taking if it substantially advances legitimate state interests. . . . ‘[P]revention of harmful use’ was merely our early formulation of the police power justification.”¹³⁹

In doing so, the Justices distinguish between the state preventing harmful use and its requiring beneficial use. Forcing Lucas to keep his land idle would fall into the latter category. Preventing *Mugler* from operating a brewery, it would seem, falls into the former. But the categories are not as neat as they first seem. The Court recognize the complexity in making this distinction, when they write that what constitutes a harm and what constitutes a benefit might vary from person to person.¹⁴⁰ This complexity further underscores the value judgments, the merit goods, at play, both by the legislature and by the Court.

Further, the Court notes these changing circumstances (from *Mugler* to present) in replying to Justice Blackmun’s dissent. Justice Blackmun wrote, correctly, that early constitutional theorists did not believe the Takings Clause embraced regulations of property at all. However, “even he does not suggest (explicitly, at least) that we renounce the Court’s contrary conclusion in *Mahon*.”¹⁴¹ Thus, even the dissenters agree that these standards are malleable and can change as the times do.

made better off at the expense of others. If the reciprocity involves a net loss, it fails on Kaldor-Hicks grounds as well.

¹³⁷ *Id.* at 1018.

¹³⁸ *Id.* at 1019.

¹³⁹ *Id.* at 1023-24.

¹⁴⁰ *Id.* at 1026.

¹⁴¹ *Id.* at 1028.

We can see this evolution as well. In 1887, the Court did not even entertain the concept of regulatory takings. By 1992, however, the Court had not only recognized the legitimacy of such claims (in *Mahon* and *Lucas*, most notably) but also placed significant restrictions on them. While avoiding set criteria to determine what was and was not a regulatory taking, the Court did allow, at least partially, the consideration of economic criteria. Though such considerations seem to undermine the merit goods argument developed above, they do not, as discussed at the close of this section.

g. *Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*

At this point, I want to briefly mention the latest case dealing with regulatory takings.

In *Tahoe-Sierra Preservation Council (TSPC) v. Tahoe Regional Planning Agency (TRPA)*,¹⁴² the TRPA enacted a moratorium on development near Lake Tahoe, Nevada while the agency devised a comprehensive land-use plan. The constitutional question was whether such a moratorium, which prohibited virtually all development for a period of 32 months, “constituted a *per se* taking of property requiring compensation under the Takings Clause of the United States Constitution.”¹⁴³

The question of whether or not the regulation constituted a taking had a two-part answer. First, there was a distinction between physical and regulatory takings. Next, if a regulatory taking occurred, the court had to determine if it was a partial taking (using *Penn Central*'s criteria) or a total taking (using *Lucas*'s criteria).¹⁴⁴

In this case, the District Court held that there was no partial taking, but that there was a total taking, since the legislation, though temporary in intent and effect, contained no expiration date. When both parties appealed, the question presented to the Supreme Court was relatively narrow: did the rule set forth in *Lucas* apply; that is, did the laws in question “den[y] the plaintiffs ‘all economically beneficial or productive use of land’”¹⁴⁵

The Supreme Court moved away from the position that a temporary moratorium on all uses of land constituted a taking: “For petitioners, it is enough that a regulation imposes a temporary deprivation — no matter how brief — of all economically viable use to trigger a *per se* rule that a taking

¹⁴² 125 S.Ct. 1465 (2002).

¹⁴³ *Id.* at 1470.

¹⁴⁴ *Id.* at 1475.

¹⁴⁵ *Id.* at 1476.

has occurred.” The Court disagreed. While the petitioners’ position would declare *any* temporary injunction a regulatory taking, the Court note in a footnote that even those regulations that are “tantamount to a condemnation or appropriation” do not necessarily constitute a taking.

Furthermore, such a trigger would be most applicable in cases of physical takings. According to the Court, petitioners tried to apply findings from physical takings to a case of a (potential) regulatory taking. Just as standard used in regulatory takings do not apply to physical takings, so too does the reverse hold.¹⁴⁶ And while *Lucas* involves a regulatory takings case that applied a categorical rule, the Court argue that *Lucas* is inapplicable in this case.¹⁴⁷ Most specifically, *Lucas* states that “compensation is required when a regulation deprives an owner of ‘all economically beneficial uses.’ . . . Anything less than a ‘complete elimination of value,’ or a ‘total loss’ . . . would require the kind of analysis applied in *Penn Central*.”¹⁴⁸

The petitioners sought to this declared a “total loss,” but the court refused. Doing so, it wrote, would define “the property interest taken in terms of the very regulation being challenged;” a circular definition. “With property so divided, every delay would become a total ban; the moratorium and the normal permit process alike would constitute categorical takings.”¹⁴⁹ The Court argued that the categorical rule established in *Lucas* was meant to apply only in “extraordinary case[s].”¹⁵⁰ In other words, even the broadest categorical rule established to protect the value of individuals’ property in the face of regulation is the exception.

h. The Connection to Merit Goods

In this section, I have examined six Supreme Court cases that dealt with the right to private property. *Mugler* established the government’s right to regulate property without compensating reductions in value. *Mahon* seemed to move away from that standard, requiring the government to compensate when PCC could no longer extract profits from its coal. The next two cases did not find a taking: *Euclid* upheld zoning laws while *Penn Central Transportation Co. v. New York* upheld historic preservation laws. In *Lucas v. South Carolina Coastal Council*, the Court established a categorical rule for compensation, saying that it was required when all

¹⁴⁶ *Id.* at 1480. See also *id.* at n.18.

¹⁴⁷ *Id.* at 1480.

¹⁴⁸ *Id.* at 1483 (citations omitted).

¹⁴⁹ *Id.*

¹⁵⁰ *Id.* at 1484.

economically viable uses of the land were prohibited. But in *Tahoe*, compensation was not required when a moratorium prevented landowners from recovering any profit on their property for a statutory period of 32 months (6 years including time spent in litigation).

But what does the formulation of a categorical rule for *per se* takings have to do with merit goods? Moreover, what does either of the two have to do with legal theory?

Throughout the section, I have provided some indication of the relevance to the merit goods argument as laid out in Part II. Yet more needs to be said. First, in the two cases in which compensation was awarded, property value was reduced to zero. In the four cases in which the landowners received no compensation (*Mugler*, *Euclid*, *Penn Central*, and *Tahoe*), property value was not zero, no matter how much it was reduced. Indeed, *Mugler* and *Ambler* both saw their property values fall by 75%. In another case, a reduction in value of 87½% was not declared a taking.¹⁵¹

Second, the Justices make an interesting point in a footnote in *Tahoe Regional*. The Chief Justice, dissenting, wrote that the moratorium of 6 years should be considered a taking. The Court replied by writing that “his dissent offers no explanation for why 6 years should be the cut-off point rather than 10 days, 10 months, or 10 years.”¹⁵² This sentence is notable because it shows that the Court, by declaring the delay to be non-compensable, is erring on the side of *limiting* property rights. I want to be very emphatic on this point. The Court is noting here that it is difficult to draw a line at exactly *when* regulation has rendered property idle for “too long.” Therefore, in the absence of a clear rule, the Court opts to limit property rights. This position, when taken in the combination with the Court’s reluctance to compensate mere reductions in value, makes the connection to merit goods clearer.

We have already seen how invocation of the police powers can carry with it an implicit merit justification. Such an exercise of the police powers, as it relates to regulatory diminution of property value, is similarly a merit goods argument.

Now we can see exactly how these cases illustrate implicit merit goods reasoning. Other scholars have defended the need for private property to be defended unconditionally, from Locke and Smith to Hayek and Posner and beyond. Indeed, Ver Eecke goes so far as to defend private property as a

¹⁵¹ *Hadacheck v. Sebastian*, 239 U.S. 394 (1915). This should be contrasted with cases of physical invasion, where even the slightest interference *is* compensated as a taking, even when there is likely a net benefit from the invasion. See, e.g., *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982).

¹⁵² 122 S. Ct. at 1487 n.34.

merit good.¹⁵³ Merit goods are applicable in cases of values legislation, whether the “value” in question is community aesthetics, public morals, or some other “good.” Thus, the value judgment by the Court in these cases was deemed sufficient grounds to limit the property rights of claimants. At the same time, the Court saw (as Ver Eecke does) the need to preserve a certain level of private property. Thus, the only cases where compensation was due were those in which property value was completely eliminated. It would be an accurate summary to say that the merit goods justification for limiting private property holds almost unconditionally; the restrictions comes at the point of (1) physical appropriation or (2) regulation that diminishes land value to zero.

i. Conclusion

In this Article, I have framed the problem as one that relates to legal theory. At this point, I want to develop this position further to set up the discussion for Part IV.

Many law and economics theorists privilege individualism. In virtually all of their theories, private property is sacrosanct, one of the most important rights of individuals; to some, it comes second only to personal inviolability. These theorists rely on the market as a political tool. Both Hayek and Nozick, for example, use explicitly economic reasoning to arrive at political ends. Buchanan similarly holds non-interference with market mechanisms as one of his primary *legal* prescriptions, while Posner, Kaplow, Shavell, and others argue that legal rules should be utility-maximizing.

But in Part II, I presented the merit goods argument to illustrate a weakness in economic theory. In this section, I presented a selection of Supreme Court cases to show how the Court has limited the right to private property, one of the most important rights to the (legal) economist. If the foundations of economic theory are flawed — or at least limited — then the writings of legal and political theoreticians who are strongly influenced by economics exhibit similar shortcomings.

This claim will be examined in detail in Part IV.

IV. Application to Political Theory

The issue of interference with individuals’ preferences is an important one when considering particular strains of legal and democratic theory.

¹⁵³ Ver Eecke, *supra* note 10, 138-40.

Moreover, as mentioned earlier, it is incredibly important when considering mainstream economic theory, which holds rationally self-interested individuals as its unit of analysis. But what is the connection between economics and politics? I ended Part III by saying that some theorists are “strongly influenced by economics.” Of course, this claim needs to be spelled out more specifically. What does such an influence entail? Which scholars exhibit that influence? After answering these questions, we can examine the limitations of these theories and the need for recognizing values — such as fairness and equity — in legal theory.

The project I outlined at the outset was to show limitations of theories that consider free market mechanisms their sole end. In this section, I first explicate the connection between economic theory and legal and political theory. I consider the intuitive claim and then examine the writings of several authors who make the connection explicitly. Next, I connect their writings, merit goods, and regulatory takings to show that the authors’ framework must be limited.

Incorporating the merit goods concept does two things. First, it illuminates the value judgments underlying all of these policy prescriptions: from Hayek to Posner to the Court’s formulation of the police powers. Second, I make the connection between their writings, economic theory (i.e., merit goods), and political reality (i.e., regulatory takings) to show theoretical framework of such authors must necessarily be limited. By incorporating the concept of merit goods, we can provide justification for policies that are outside of these authors’ theories, while still retaining the majority of their prescriptive conclusions.¹⁵⁴

a. The Economic Connection

Throughout this Article, I have referred in passing to “normative economics.” But what exactly does this term mean? What is the normative component of economics? To answer these questions, I refer to the traditional distinction in economics textbooks. While relatively simplistic, this distinction is important because it underscores economists’ understanding of their work as being value-free. For example, Nicholson says that normative economics takes “a definite stance about what *should* be

¹⁵⁴ I do not wish to discuss the relative merits of the various theorists’ prescriptions here. I will suffice it to say that if the economic model upon which their theories are based — and the theories themselves — are limited, then introduction of the merit goods concept enriches their theories. Whether their conclusions (after this modification) are desirable or not can be left for the reader to decide. It is, however, likely that the theories are more likely to be seen as internally inconsistent when the concept is introduced.

done,” while positive economics “seeks to determine how resources are *in fact* allocated in an economy.”¹⁵⁵ Perloff maintains a similar distinction: positive economics involves scientific relationships between cause and effect, while normative economics involves value judgments about good and bad.¹⁵⁶

But is this distinction necessarily complete? Economists routinely make assumptions about individuals, behavioral characteristics, and market structures, all in the name of positive economics. Moreover, every story an economist tells includes certain (important) facts while discarding other (presumably unimportant) facts. This approach is perfectly acceptable when evaluating, say, the costs and benefits associated with trade between two countries: economic assumptions underlying an economic problem are used to answer an economic question. However, a problem arises when this framework, designed to apply to a relatively narrow field of study, is used as the basis from which other policy prescriptions are made. Economics, like any other science, makes predictions based on models created with the purpose of closely mirroring real-world events. But that model, of a “perfectly competitive market . . . where economic agents are fully informed and perfectly rational, is a fiction. It does not exist, nor is it even approximated, in the real economic world.”¹⁵⁷ Insofar as that model is imperfect — and every model is, to a greater or lesser extent — the economist must make decisions about how to fit data to a particular model and why. Therefore, “positive economics,” hailed by economists as telling us what “in fact” happens in the world, dispassionately and devoid of any values, is still strongly influenced by particular values and assumptions that may not always be appropriate.

It is not my intention to delve into philosophical questions regarding the objectivity of the sciences. However, I want to point out that, at least in economics, questions involving value judgments are of a much broader scope than might seem initially apparent. Indeed, even traditional equilibrium analysis supposes that Pareto-optimality ought to be valued. It is possible to envision economic theories that do not hold the individual as the unit of analysis, that do not value efficiency, or that focus on questions of distribution rather than production. In mainstream economic theory, there are assumptions *a priori* that affect the theory’s conclusions. It is not

¹⁵⁵ Walter Nicholson, *MICROECONOMIC THEORY: BASIC PRINCIPLES AND EXTENSIONS* 8 (7th ed. 1998).

¹⁵⁶ Jeffrey M. Perloff, *MICROECONOMICS* 8 (1999).

¹⁵⁷ Colin M. Macleod, *LIBERALISM, JUSTICE, AND MARKETS: A CRITIQUE OF LIBERAL EQUALITY* 1 (1998).

surprising that there is an extraordinary degree of similarity between major economics textbooks.¹⁵⁸

Thus the claim might be made that economics teaches a way of thinking about the world as much as it teaches empirical means of analysis. This is the point Nelson stresses, when he says that economics has become a “religion” in the United States. After working for the U.S. government, Nelson noticed that “the details of formal economic calculations had little to do with most policy decisions . . . the greatest influence of economists came through their defense of a set of values.”¹⁵⁹ Economists argued *for* strong self-interest in particular settings (profit-seeking a competitive market is good) and *against* it in others (rent-seeking as a government employee is bad). Nelson paints the recent influence of economics in strongly religious terms, saying that “members of economic schools since Adam Smith have been the most influential priests of the modern age.”¹⁶⁰

This leads to an interesting paradox: while “the market” gives equal weight to competing value claims and is supposedly value-neutral, the very assumptions and theoretical tools that make market analysis possible are value-laden. Moreover, in terms of influence, it seems that the values that underlay the calculations conducted are more important than the calculations themselves!

b. The Connection to Law and Political Theory

At this point, the preceding discussion seems beyond the scope of my analysis. In an Article considering legal theory, why should we be concerned with the values that influence economics? First, there is the intuitive sense that economics influences law. Indeed, if economists who work for the government advocate particular values rather than report “hard data,” it seems that legal theorists should be even more concerned about the influence of economics. In Part I, I wrote of the hegemony of economics in the social sciences. Other authors carry this argument forward: Nelson writes that “[e]conomic efficiency has been the greatest source of social legitimacy in the United States for the past century,”¹⁶¹ and Macleod says that the “fiction” of a perfectly competitive market “exerts enormous influence in modern political theory. . . . Similarly, the ideal market enters

¹⁵⁸ This homogeneity has been criticized. See Edward Fullbrook, *A GUIDE TO WHAT'S WRONG WITH ECONOMICS* (2004).

¹⁵⁹ Robert H. Nelson, *ECONOMICS AS RELIGION: FROM SAMUELSON TO CHICAGO AND BEYOND* xvi (2001).

¹⁶⁰ *Id.* at 20.

¹⁶¹ *Id.* at xv.

normative political philosophy.”¹⁶² And as Richard Posner points out, economic analysis of law has been the dominant legal theory over the past three decades.¹⁶³ Part II outlined a shortcoming of mainstream economic theory. If this is true, then the legitimacy of efficiency calculations is sharply limited.

But the link to legal and democratic theory can be made even more strongly. Quite simply, there are a significant number of democratic theorists whose writings place a high value on market-based economics. In this section, I examine the writings of Friedrich A. von Hayek, Robert Nozick, James M. Buchanan, and Judge Richard A. Posner to show that the assumptions and outcomes of economic theories play a very significant role in legal and political theory.¹⁶⁴

i. Friedrich A. von Hayek

One of the earliest and most influential writings in the strain of right-liberalism was Friedrich A. von Hayek’s *The Road to Serfdom*. Published at the end of World War II, Hayek’s book came at a time when socialism was enjoying relatively broad influence around the world. Hayek’s theory was based strongly on economics; he argued that a system was to be premised on one condition, “namely, that the owner benefits from all the useful services rendered by his property and suffers for all the damages caused to others by its use.”¹⁶⁵

Hayek’s individualistic conception of the economic realm extends to his theoretical of the democratic process. Individualism, he writes, must be at the core of democracies, for “when it becomes dominated by a collectivist creed, democracy will inevitably destroy itself.”¹⁶⁶ More important for our purposes, Hayek explicitly makes a capitalistic free market a *political* end: “If ‘capitalism’ here means a competitive system based on free disposal over private property, it is . . . important to realize that only within this system is democracy possible.”¹⁶⁷ Thus Hayek not only espouses market

¹⁶² Macleod, *supra* note 157, at 1.

¹⁶³ See *infra* note 184.

¹⁶⁴ These authors are not the only such authors, but they are among the most influential. Ronald Reagan, for example, cited Hayek as one of the thinkers who most influenced his conduct. See Ronald Chen & Jon Hanson, *The Illusion of Law: The Legitimizing Schemas of Modern Policy and Corporate Law*, 103 MICH. L. REV. 1, 13 & n.42 (2004). James M. Buchanan is a Nobel-prize winning economist, and Richard Posner has been one of the giants of the law and economics movement for the past three decades.

¹⁶⁵ FRIEDRICH A. VON HAYEK, *THE ROAD TO SERFDOM* 38 (1944).

¹⁶⁶ *Id.* at 70.

¹⁶⁷ *Id.* at 69-70.

economics but also makes the market an explicitly political tool. There is also a strong connection between Hayek's theory and private property.¹⁶⁸ But if the merit goods argument can be employed to limit something as fundamental as an individual's right to private property, it can be used to limit other, lesser rights as well. The importance that Hayek places on private property will become important to such an analysis later.

Hayek expands the importance he places on economics later in his book. Initially, he drew a strong connection between economics and politics. Later, he makes the connection to other areas of people's lives as well, when he writes that it is an "erroneous believe that there are purely economic ends separate from the other ends of life." Since there are no such things as "purely economic ends," *everything* can be analyzed in economic terms. Hayek leaves no doubt on this point, writing that, strictly speaking, "there is no 'economic motive' but only economic factors conditioning our striving for other ends."¹⁶⁹

Hayek uses this argument to take on critics who contend that people are not motivated by economic (i.e., monetary) factors. He acknowledges that this may be true and that individuals might have other reasons for acting as they do. But he contends that it is precisely a free market system, which gives equal weight to competing value claims, that allows them to do so. In other words, a free market allows individuals to order their own preferences. If I prefer some non-economic end, I am allowed to do so precisely *because* the market allows for competing value claims. Moreover, since it is the market structure that allows such claims, economic analysis can apply even when the ends in question are non-economic.¹⁷⁰ This, of course, further establishes the free market as a political end.

Finally, lest there be any doubt in the reader's mind that Hayek is taking economics to be the only means by which social goals of any sort can be realized, he proclaims, "It may sound noble to say, 'Damn economics, let us build up a decent world'— but it is, in fact, merely irresponsible."¹⁷¹

As one might expect from a theorist who espouses economics, Hayek is staunchly in favor of the right to private property. He writes that "the system of private property is the most important guaranty of freedom . . . It is only because the control of the means of production is divided among many people acting independently that nobody has complete power over us, that we as individuals can decide what to do with ourselves."¹⁷² Later, he

¹⁶⁸ See *infra* notes ____ - ____ and accompanying text.

¹⁶⁹ Hayek, *supra* note 165, at 89.

¹⁷⁰ *Id.* at 91.

¹⁷¹ *Id.* at 210.

¹⁷² *Id.* at 103-4.

quotes Max Eastman as saying that the free market and private property were the preconditions for the evolution of all democratic freedoms.¹⁷³

ii. Robert Nozick

In *Anarchy, State, and Utopia*, Robert Nozick updates the case for a minimal state. Such a state, which adjudicates disputes and protects individuals' rights, is "the most extensive state that can be justified. Any state more extensive violates people's rights."¹⁷⁴ Nozick's libertarian position is rather extensively spelled out in his book. In doing so, he presents a variety of arguments, counterarguments, and responses. As with my analysis of Hayek, it is not my intention to explore all of these completely. Nor is it my goal to provide a comprehensive critique of libertarianism. Instead, I want to examine those aspects of Nozick's theory that are influenced by economics in order to show how his theory, by failing to recognize the merit goods argument, is limited.

Nozick envisions a state of nature which ultimately results in some initial distribution of property. After this point, property can only be acquired by one of two means: a just acquisition (mixing one's labor with theretofore unclaimed property) or a just transfer (a sale or gift). Any other means of transfer would be illegitimate.¹⁷⁵ This point is important here. Limiting someone's property rights for some extra-economic end (quality of life, historic preservation, and environmental protection, etc.) seems to be a violation of her rights. The regulatory takings that were not recognized by the Court would then appear to be illegitimate under this theory since they do not meet either of the principles of transfer noted above.

Nozick is insistent upon this point, saying that "redistribution [of property or money] is a serious matter indeed, involving, as it does, the violation of people's rights."¹⁷⁶ This statement is important in two respects. First, Nozick is stating his position against redistribution of property (we can see how a limitation of land use to favor some more than others may be considered "redistributive" in the loosest of senses). Second, he is explicitly stating that such a redistribution is illegitimate because it interferes with inviolable rights. In other words, not compensating a regulatory taking would be an illegitimate course of action for the minimal state. In the context of the *Penn Central* case, New York City's Landmarks Law

¹⁷³ *Id.* at 104-5.

¹⁷⁴ ROBERT NOZICK, *ANARCHY, STATE, AND UTOPIA* 149 (1974).

¹⁷⁵ *Id.* at 151.

¹⁷⁶ *Id.* at 168.

required property owners to maintain their historical properties. To Nozick, such a forced contribution is tantamount to forced labor.¹⁷⁷

Nozick uses the term “patterned principles of distributive justice” to refer to centralized planning goals. While the phrase is used in the context of capitalist versus socialist economies, it applies to this case study as well. Land use regulations involve some element of planning in the name of some distributional principle. Saline County, Kansas, for example, wanted breweries to be distributed in a particular way (i.e., not at all), while the Village of Euclid wanted a different distribution of residential and commercial land. Thus Part III’s case study would be illegitimate, because “patterned principles of distributive justice involve appropriating the actions of other persons;” they forcing one to work for another’s benefit.¹⁷⁸

Thus far, Nozick’s use of language and ideas that seems to indicate a strong economic influence. Indeed, in Nelson’s words, we might say Nozick is advocating an “economic” set of values. But the connection is even stronger. This can be seen through Nozick’s references to “the market.” The market is an institution comprised of individuals who buy and sell goods. But Nozick makes the market a political tool, saying that it is a way to achieve noninterference with individuals’ values, since “the market is neutral among persons’ desires.”¹⁷⁹ Indeed, just as the market is neutral but confers benefits upon individuals in varying, unequal degrees, so too is Nozick’s minimal state: though it is neutral among its citizens values and desires, it is differentially beneficial in that some citizens are made better-off than others by its framework.¹⁸⁰

iii. James M. Buchanan

In The Calculus of Consent, Nobel laureate James M. Buchanan and Gordon Tullock provide a theory of collective action and organization. This theory, they say at the outset, is “about the *political* organization of a society of free men . . . derived, essentially, from the discipline that has as its subject the *economic* organization of such a society.”¹⁸¹ Their theory of political choice and collective action, they say, is “analogous to the

¹⁷⁷ *Id.* at 169.

¹⁷⁸ *Id.* at 172.

¹⁷⁹ *Id.* at 163.

¹⁸⁰ Nozick contends that policies that result in differential benefits can still be legitimate and neutral in a minimal state. *Id.* at 272-3. I return to this claim later. See *infra* note 207 and accompanying text.

¹⁸¹ JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY v (1962).

orthodox [i.e., neoclassical] economic theory of markets.”¹⁸² But Buchanan and Tullock are not as cavalier as the typical micro-theory textbook author when it comes to their assumptions. Their model, they note, is based on the assumption that humans are utility-maximizing rational actors. This entire approach, they are careful to note, “must embody philosophical commitments.”¹⁸³

Buchanan is yet another author who explicitly takes economics and applies it to non-economic phenomena. While most economists are silent about the ethical underpinnings to their theory, however, Buchanan and Tullock are not. Recognizing the role of philosophical commitments, Buchanan and Tullock make explicit the ethical judgments that are at the foundation of their (and everyone else’s) theory.

iv. Richard A. Posner

Perhaps the best-known legal economist, and certainly one of the most influential, is Judge Richard A. Posner. In 1972, then-Professor Posner published his textbook, *Economic Analysis of Law* (he was appointed to the federal bench by President Ronald Reagan in 1981). Three decades later, the book is still popular among legal scholars. As Posner points out, the law and economics movement has, in those intervening decades, “outlasted legal realism, legal process, and every other one of the twentieth century’s new fields of legal scholarship.”¹⁸⁴ And that’s not all: the field “shows no signs of abating”¹⁸⁵ Any discussion of economic and legal theory, then, must account for Judge Posner’s arguments.

Like the authors mentioned above, Posner explicitly adopts economic reasoning to explain, describe, and propose legal rules. Indeed, the very project is designed to dispel the myth that “economics is the study of inflation, unemployment, business cycles, and other mysterious macroeconomic phenomena remote from the day-to-day concerns of the legal system. Actually, the domain of economics is much broader.”¹⁸⁶

¹⁸² *Id.* at 17.

¹⁸³ *Id.* at 265.

¹⁸⁴ Richard A. Posner, *ECONOMIC ANALYSIS OF LAW* 28 (2002)

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 3. Of course, one might ask *why* the domain of economics is broader. Is it simply fiat? It is worth noting the last two sentences of Posner’s book. After puzzling over the fact that rules regarding interrogation of criminal suspects may not be cost-justified, he writes: “So law and economics are not perfectly congruent after all. But you knew that.” *Id.* at 716. This is a cute closing, , but one that masks the problems under the surface. I have tried to bring some of these problems — those involving ethical judgments — to light in this Article.

Posner's legal analysis derives fundamentally from economic theory. The first chapter of the book is an introduction to economics, and economic reasoning underlies the rest of the book; Posner covers fields as diverse as Contracts, Family Law, Constitutional Law, and Evidence. He does so to illustrate "the congruence between the doctrines of the common law and the principle of economic efficiency."¹⁸⁷

Unlike Hayek, Nozick, or even Buchanan and Tullock, Posner does not argue that the market should *per se* be the end of legal policy. Instead, he argues that the common law *is and has been* geared toward economic efficiency, that "the common law is best (not perfectly) explained as a system for maximizing the wealth of society."¹⁸⁸ This norm of utility maximization stems from "[t]he basic assumption, . . . [of] a disposition to choose, consciously or unconsciously, an apt means to whatever ends the chooser happens to have."¹⁸⁹ And Posner is careful to bracket the normative aspects of the theory off from the positive. While an economist "cannot tell society whether it should seek to limit theft, he can show that it would be inefficient to allow unlimited theft."¹⁹⁰

There is one final point to be made about Posner's analysis. While Pareto-optimality underlies economic theory, Posner acknowledges, as many do, that "[t]he conditions for Pareto superiority are almost never satisfied in the real world." Instead, Posner employs the "less austere concept" of Kaldor-Hicks efficiency. But even under this scheme, the "winners could compensate the losers;" as such, society is presumed to be better off and the transaction is desirable from a social welfare perspective.¹⁹¹

My discussion of Posner is intended to be illustrative rather than exhaustive with regard to law and economics scholarship. The sheer number of such scholars makes a comprehensive discussion impractical. However, the key insight of this section is that Posner's economic analysis of law turns on the same presuppositions and assumptions that Hayek, Nozick, Buchanan, and Tullock employ. Indeed, a wide variety of other

¹⁸⁷ *Id.* at 31.

¹⁸⁸ *Id.* at 25. Note, however, that this claim has been challenged elsewhere. See Jon D. Hanson & Melissa Hart, *Law and Economics*, in BLACKWELL'S COMPANION TO PHILOSOPHY OF LAW AND LEGAL THEORY 311-31 (Dennis Patterson, ed., 1996).

¹⁸⁹ Posner, *supra* note 184, at 17. This idea, that people "choose" to pursue "whatever ends the chooser happens to have," dovetails perfectly with similar sentiments expressed by Hayek. See *supra* note 170 and accompanying text.

¹⁹⁰ Posner, *supra* note 184, at 24.

¹⁹¹ *Id.* at 13. See also *supra* note 2 and accompanying text.

law and economics scholars share these same fundamental tenets.¹⁹² Thus, while Posner is but one of many authors in the law and economics field, the characteristics of his analysis are common to virtually all such scholars.

Posner's analysis is primarily positive (though even this carries with it implicit value judgments); Kaplow and Shavell take this one step further and argue for a *normative* system in which legal rules are explicitly and exclusively welfare-maximizing; "notions of fairness like corrective justice should receive no independent weight in the assessment of legal rules."¹⁹³ The merit goods argument, applied to law and economics below, applies to both positive and normative economics but with more force to the latter.

At I conclude this section, I want to clarify my project here. There are a number of ways in which people can, and have, objected to various aspects of the theories of all of these authors. It is not my intention to do so here or even to survey those criticisms. Instead, I want to note that for all of these authors, economics is adopted as the *end* of social, legal, and political life. The purpose of my paper is not to raise an objection to the nature of capitalism itself or even to the connection between capitalism and democracy. However, as the merit goods argument has shown, mainstream economic theory is unable to accommodate value judgments in its traditional framework. Thus, when policies require some set of values to be adopted (say, toward the end of historical preservation), economics is unable to deal with the matter on its own terms. As our survey of regulatory takings cases shows, there is a trend in Supreme Court decisions indicating that our political system favors a distinction between legal and economic questions. Thus, after providing theoretical and empirical reasons why economic theory and political theory do not coincide, it is inappropriate to consider the free market to the sole basis for, or goal of, legal theory. While the market may be a *means* toward other goals, such as an efficient distribution of resources, it is merely embodies *one* set of values that must compete with others in law and politics.

c. The Connection to Merit Goods

By now, it is clear that a number of theorists advocate theories that are strongly influenced by economics, relying on the fundamental precepts of economic theory — individualism, governmental noninterference, and private property. However, in Part II, I outlined the merit goods argument

¹⁹² See, e.g., ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS (2004); Louis Kaplow & Steven Shavell, FAIRNESS VERSUS WELFARE (2002).

¹⁹³ Kaplow & Shavell, *supra* note 192, at 4.

in order to illustrate a shortcoming in mainstream economic theory; questions of ethics are outside the scope of economics. We can see how this works by considering, for example, Nozick's statement that the market is neutral among persons' desires.¹⁹⁴ If this is true, "the market" serves both morally-desirable and morally-undesirable ends equally; actions that hinder public health, safety, welfare, or morals are just as possible — and appropriate — as those that further them. When phrased this way, we see explicitly that the police powers are essentially a remedy for an economic shortcoming.¹⁹⁵

A variety of authors confirm this intuition. Pindyck and Rubinfeld, in their textbook on microeconomic theory, say that "[w]hen value judgments are involved, microeconomics cannot tell us what the best policy is."¹⁹⁶ More interesting for our purpose is Miceli and Segerson's analysis of regulatory takings. Their book provides a comprehensive treatment of regulation and compensation, using economic analysis to determine when compensation is and is not appropriate. But even they note at the outset that while they adopt traditional efficiency approaches to takings questions, "in many cases efficiency alone does not generate a unique solution to the takings questions." Specifically, economic analysis does not typically consider "the distributional or fairness aspects of the problem."¹⁹⁷

Thus, the problem identified at the outset of this study is increasingly intertwined with legal theory. First, the merit goods problem cannot be solved without adopting an interdisciplinary approach to economics questions at the level of collective goods. Second, efficiency analysis alone is not always adequate for answering certain policy questions, including regulatory takings. But might this analysis still somehow be incomplete? Are the cases I have chosen to illustrate merit goods reasoning the exception to the rule? Are there other cases where efficiency analysis *is* adequate and merit goods are irrelevant?

Although an exhaustive survey is beyond the scope of my study, there are two answers. On an empirical level, Miceli and Segerson seem to indicate that this is not the case. For example, in their discussion of *Penn Central*, they note that "it would be very difficult to collect from all passerby who enjoy looking at the [historic] building in its preserved state,

¹⁹⁴ Nozick, *supra* note 174, at 163.

¹⁹⁵ The relation to regulatory takings should be clear as well. See, e.g., *Euclid*, 272 U.S. at 387: "[zoning laws] and all similar laws and regulations must find their justification in some aspect of the police power."

¹⁹⁶ ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 7 (7th ed. 2001).

¹⁹⁷ THOMAS J. MICELI & KATHLEEN SEGERSON, COMPENSATION FOR REGULATORY TAKINGS: AN ECONOMIC ANALYSIS WITH APPLICATIONS 6-7 (1996).

and virtually impossible to collect from all those who derive benefits simply from knowing that it has been preserved.”¹⁹⁸ It is hard to think of a better example of a market failure at the public goods level which requires government intervention. But it is not simply a question of (ostensibly positive) economics. The authors also note that the Supreme Court asserted that land speculators are not entitled to protection under the takings clause since they “are engaged in a socially undesirable activity”¹⁹⁹ — clearly, a value judgment.

There is also an answer sounding in theory. While economics values choice and consent, there are certain elements of the system that are protected with inalienability rules. Private property, binding contracts, and a judiciary fall into this category. Thus, even at this most basic level, there are strong merit goods interferences with “free choice.”²⁰⁰

d. Economics Revisited

By now, the connection between legal theory and merit goods is clearer. Specifically, let us assume that value judgments are required in law. If one’s political theory lacks theoretical apparatus by which value judgments are made — if one’s theory is based in economics — then the theory would be unable to account for a wide range of public policies. But would this really be problematic? True, historic preservation might be outside the scope of, say, Hayek’s theory. But what if all goods of this kind, all merit goods, are simply dismissed as illegitimate?

This is simply not the case. Each of the authors examined above has points in his presentation that implicitly rely on the merit goods concept. I start, again, with Hayek.

In another one of his books, *Individualism and the Economic Order*, Hayek writes that

many of the institutions on which human achievements rest have arisen and are functioning without a designing and directing mind. . . . The spontaneous collaboration of free men often creates things which are greater than their individual minds can ever fully comprehend.²⁰¹

¹⁹⁸ *Id.* at 181.

¹⁹⁹ *Id.* at 179.

²⁰⁰ Ver Eecke, *supra* note 55, at 138-40; *see also supra* note 72 and accompanying text.

²⁰¹ FREIDRICH A. VON HAYEK, *INDIVIDUALISM AND THE ECONOMIC ORDER* 7 (1948).

This, of course, is the classical “invisible hand” explanation, first popularized (as Hayek notes) by Adam Smith.²⁰² But as explicated here by Hayek, there seems to be a socially desirable end in mind. In other words, markets are not left unregulated — individuals are not left “free” — *only* for a deeper philosophical reason; rather, it is ostensibly the best way to produce the highest level of social utility. Hayek explicates this further, saying that Smith’s system was not designed to cater to what man might achieve at his best; rather, it was designed to be “a system under which bad men can do least harm.”²⁰³ In a system such as Smith’s, Hayek contends that “man could be induced, by his own choice and from the motives which determined his ordinary conduct, to contribute as much as possible to the need of all others.”²⁰⁴

This line of argument is interesting for one main reason: Hayek seems to be implying that the market is merely a *tool* for some social end. Although other writings of his (as examined earlier) suggest a different conclusion, it would appear that at its most basic level, Hayek’s theory relies on merit goods. Specifically, if the system is fashioned so that men “contribute as much as possible to the need of all others,” then it is conceivable, at least, that a policy that burdened some more than others (to use the language from *Penn Central*) contributed more to the satisfaction of the needs of society than one which was Pareto-optimal (or even Kaldor-Hicks optimal). Thus even Hayek’s strongly individualistic theory can accommodate the concept of merit goods.

So too with Nozick, whose view on property rights derives from the Lockean proviso. This view justifies transfers of property (1) if one mixes his labor with unappropriated property or (2) if a fair transfer of property takes place. However, Locke places an interesting constraint on these transfers: he says that there must be “enough, and as good left in common for others.”²⁰⁵ It is possible to conceive of a case where I buy a plot of land and ruin it aesthetically and environmentally. We can imagine that there is neither enough nor as good of an environment in the area after my negligence as there was before. Thus the very proviso through which

²⁰² This should further convince the reader of the strong connection between Hayek and classical economic theory. Nozick also devotes some time at the beginning of his book to characterizing his theory as an “invisible hand” explanation. Nozick, *supra* note 174, at 18-22.

²⁰³ Hayek, *supra* note 201, at 11.

²⁰⁴ *Id.* at 13.

²⁰⁵ Locke, *supra* note 77, at 20.

Nozick frames property rights can be used to justify merit goods interference to require environmental protection or historic preservation.²⁰⁶

Nozick also says that one could object to the minimal state by saying that it is nonneutral with regard to its citizens. For example, a law might be instituted against rape. Such a law would clearly be disparate in its benefits and costs, since all potential victims of rape benefit while all potential rapists are harmed (in a strict utility-measuring sense). Moreover, since the overwhelming majority of rapists are male and the overwhelming majority of rape victims are female, it might be said that the law confers differential benefits based on sex. But is this really nonneutral? Nozick does not seem to think so. The law is neutral, he says, because there is “an *independent* reason for prohibiting rape . . . people have a right to control their own bodies, to choose their sexual partners, and to be secure against physical force and its threat.”²⁰⁷

All of these are perfectly legitimate reasons for prohibiting rape. Nozick calls these independent justifications; a prohibition that is independently justifiable but works out to affect different persons differently can still be considered neutral. But note what Nozick does *not* say: he has made a moral judgment that deems one thing right (self-control over one’s body) and another wrong (physical force). Similarly, when he says that the minimal state can be considered neutral because there are independently justifiable reasons — values — for its existence, he is again making a moral judgment and imposing it on a given populace. Even in Nozick’s strongly libertarian theory, there are elements of values, clearly a merit good.

Buchanan and Tullock’s theory similarly requires the merit goods concept. In a section entitled “Democratic Ethics and Economic Efficiency,” the authors puzzle over the inability of economics to make ethical determinations. Since their theory very explicitly takes economic theory and turns it into political theory, their vision of the state seems like it would similarly be limited. They consider a case where one individual successfully initiates collective action against another person (or group) since he was experiencing some negative utility. Taken to an extreme, this would mean that everyone would attempt to initiate collective action to force others to adopt his conception of the good. This is problematic

²⁰⁶ It is true that the Lockean proviso is most applicable in man’s primitive state. But since economic analysis ostensibly can be applied to such situations, I find it appropriate to use the merit goods argument here as well.

²⁰⁷ Nozick, *supra* note 174, at 273.

(among other reasons), since there is no theoretical name by which they can classify such action.

Buchanan and Tullock brush the problem aside, saying that there is usually “sufficient standardization of moral values over the population of a community” so that such problems do not arise. But even if this is true, they recognize the larger problem: there is no “dividing line between the many trading or exchange activities that are generally accepted” and those that are not.²⁰⁸ It is thus clear that the theory would be much more complete if the merit goods concept were introduced. The value judgment involved in a decision on what exchanges are accepted and what are not is a merit good decision. A trade or exchange that is prohibited can be considered a pure demerit good (say, banning illicit drugs or prostitution). The concept of merit goods then becomes the theoretical tool by which the distinction is made — it is the “dividing line” they seek.

But while Buchanan and Tullock claim in their book that there is no “dividing line” between acceptable and unacceptable market transactions, an Article by Buchanan suggests otherwise. In “Fairness, Hope, and Justice,” he says that one’s “claims to holdings [can] be interpreted as one component in the outcome of what we might agree is a *fair game*.”²⁰⁹ What then are the rules that need to be imposed on a free market so that the economic “game” can be considered fair?

Buchanan identifies four factors that influence one’s economic outcome: (1) choices, (2) birth, (3) luck, and (4) effort. But while an individual deserves what comes of his effort and choices, she has no control over her birth status or luck. Since social policy cannot feasibly affect outcomes based on luck, Buchanan examines the role of birth.²¹⁰ Birth is something that the individual cannot control, and has not earned, that plays a very large role in her success. Therefore, Buchanan proposes imposing certain “handicaps” to neutralize the effect of birth as much as possible. Specifically, he proposes a heavy inheritance tax, even though “such taxes are Pareto-inefficient,” and subsidy of public education, so as to mitigate as much as possible natural differences arising from birth.²¹¹

Buchanan acknowledges that the proposals he is making are inefficient. Moreover, he notes that they are not even public goods; to classify them as such would “shift[] attention away from the central issues.”²¹² To

²⁰⁸ Buchanan & Tullock, *supra* note 181, at 270.

²⁰⁹ James M. Buchanan, Fairness, Hope, and Justice, *In* NEW DIRECTIONS IN ECONOMIC JUSTICE 55 (Roger Skurski ed., 1983).

²¹⁰ *Id.* at 58.

²¹¹ *Id.* at 63-5.

²¹² *Id.* at 64.

Buchanan, the central issue here is not economic efficiency or even the provision of positive public externalities. Rather, it is the concept of “fairness,” raised earlier, that drives Buchanan’s theory. In other words, Buchanan is making a value judgment to override market mechanisms, delineating some transactions (inheritances) as less normatively desirable than others (education). While Buchanan claims that the rules of fairness are effecting a change in market structure *before* the game is played, at the beginning of an individual’s life, he cannot deny that he is using merit goods reasoning to make his case. Finally, as he noted at the outset of his book, the economic theory “must embody philosophical commitments.”²¹³ These are, of course, value judgments — merit goods.

Finally, the legal economists’ theories are similarly lacking without recognizing the merit goods concept. On one level, this claim should be the most intuitive by this point. Part II, which developed the merit goods argument, applies to economic theory; since authors like Posner are simply engaging in economic analysis, the argument is equally-applicable to them.

But a bit more needs to be said. Posner, for example, considers the Pareto criterion to be based on “unanimity;” after all, A would not sell his wood carving to B for \$100 unless they both assented to it.²¹⁴ But there are a whole set of background assumption regarding which A and B are asked for their consent. If B backs out of paying for the carving, A can bring him to court, where a judge will enforce the contract. If B steals the carving, A can sue him for a tort conversion claim or press criminal charges. In none of these cases is B permitted to “opt out” of the regime.²¹⁵

When pressed, a legal economist might agree that there is, in fact, imposition; indeed, all court-ordered judgments are backed by the coercive power of the state. However, the court is simply determining *ex post* the same arrangement that the parties would have contracted to *ex ante* if they had access to full information: the court “attempts to reconstruct the likely terms of a market transaction . . . to mimic or simulate the market.”²¹⁶

But even Posner’s market-mimicking legal system has problems. Posner himself admits that the Kaldor-Hicks criterion does not have a clearly-defined “ethical basis.”²¹⁷ And while the Pareto criterion is

²¹³ Buchanan and Tullock, *supra* note 181, at 265.

²¹⁴ Posner, *supra* note 184, at 12.

²¹⁵ Ver Eecke has argued that the conditions necessary for the possibility of a free market are themselves, merit goods. Property, enforceable contracts, bankruptcy laws, and a judiciary are all examples of such merit goods. See *supra* note 72 and accompanying text.

²¹⁶ Posner, *supra* note 184, at 16.

²¹⁷ *Id.*

premised on utilitarianism,²¹⁸ this hardly solves the problem. After all, critiques of utilitarianism abound, from Kant to Rawls and beyond.

Posner recognizes this, at least implicitly, in his introduction to the concept of efficiency. Efficiency, he writes, is premised on utility, which in turn is based on maximization of individuals' happiness.²¹⁹ But Posner acknowledges that "most people don't believe — and there is no way to prove them wrong — that maximizing happiness . . . is or should be one's object in life."²²⁰ But this hardly answers the question! If *most* people don't believe in merely maximizing happiness, then on what ethical basis are the courts taking it as their duty to *force* people to do so? In moral philosophical words, if people aren't utilitarians, why should courts force them to be?

Posner provides a justification for the Kaldor-Hicks model: wealth maximization is desirable because "the things that wealth makes possible . . . are major ingredients of most people's happiness, so that wealth maximization is instrumental to utility maximization."²²¹ But notice the tension between this statement and one just pages before: if "most" people don't believe that happiness is the only thing that matters, then why difference does it make if wealth maximization furthers that goal? Put another way, maybe another regime — one *not* rooted in individual wealth maximization — would better serve what people truly want instead of what Posner and legal economists *assume* they want!

At heart, this is an empirical question. The goal of my project is not to determine what people truly want or even how to efficiently deliver some agreed-upon end. Instead, it is simply to point out that even Posner's economic analysis of law rests fundamentally on imposing certain moral views (utilitarianism, wealth maximization) at the expense of others. By Posner's own admission, this end goal runs counter to what he thinks most people believe. There may be nothing wrong with utilitarianism, and perhaps it is the best way to frame policy decisions. But anything that stems from such a premise is undoubtedly based on merit goods reasoning.²²²

²¹⁸ *Id.*

²¹⁹ *Id.* at 11-12.

²²⁰ *Id.* at 12.

²²¹ *Id.* at 16.

²²² This, of course, applies equally to Kaplow and Shavell, and perhaps even more so, because they explicitly tie their economic theory to traditional theories of moral philosophy. Kaplow & Shavell, *supra* note 192, at 1-7. While they consider this to be consistent with the welfare-maximizing approach (and it may well be), the issue is not beyond debate; for example, Ver Eecke draws on Kant to justify merit goods, *see supra* note 72, while they draw on Kant to justify welfare-maximization. *See id.* at 3.

e. Nature of the Critique

The foregoing has described the theories presented by right-liberals and the degree to which they rely on economic thinking to formulate their positions. However, it should be very clearly noted that economics does — and should — have a place in contemporary public policymaking. Economic and econometric techniques can be extremely powerful tools in analyzing and predicting social phenomena. However, in this Article, I have contended that economic theory is incomplete in the sense that it is unable to distinguish between competing moral claims. While this still constitutes a critique of economic theory, it is different from other critiques. Here, I will briefly survey three types of critiques of economic theory and explain how my discussion is different.

The first type of critique seeks to invalidate the unit of analysis of economics. At its core, micro-theory is about the actions of rationally self-interested atomistic actors. However, several people have criticized this fundamental unit. Lowi, for example, criticizes what he calls an “interest-group liberalism,” in which the primary political actors are not individuals, but rather the political pressure groups to which they belong.²²³ Similarly, Etzioni writes that individuals must be understood “within the context of their collectivities.”²²⁴ In other words, these authors contend that the autonomous individual should not be the central figure in economic thinking, challenging the premise that economics can be understood as the actions of “atomistic actors.”

A second type of critique of economics speaks to the behavioral foundations of economic theory. Perhaps the most famous proponent of this position is Amartya Sen, whose Article “Rational Fools” criticized the assumption that humans were always “rationally self-interested” actors. Jane Mansbridge’s collection of essays entitled *Beyond Self-Interest* draws on a variety of disciplines to make this same point: self-interest is not always what motivates individuals. Note here that both Sen and Mansbridge accept that the individual can be the unit of analysis; they simply deny that he always behaves like *homo oeconomicus*.

The third critique I consider is the one Nelson presents: that the primary function of economists in policymaking fields is not to analyze data or give reports; rather, they advocate simply for viewing the world as comprised of rationally self-interested atomistic actors. Turning Nelson’s observation

²²³ See generally THEODORE LOWI, THE END OF LIBERALISM: THE SECOND REPUBLIC OF THE UNITED STATES (1979).

²²⁴ AMITAI ETZIONI, THE MORAL DIMENSION: TOWARD A NEW ECONOMICS 181 (1988).

into a normative statement, we can say that economic theory *ought to* advocate a set of values and abandon its calculations altogether.

Finally, there is the critique that draws on all of these. As Jon Hanson has argued persuasively, people are not dispositionist, rational actors; instead, they are “situational characters.” Hanson’s is a wholesale empirical critique of economics.²²⁵

My project in this article is none of these. Instead, I accept the unit of analysis, the behavioral assumptions, and the calculative and predictive power of contemporary economics. However, I contend that, as the merit goods argument shows, there are certain economic policies — collectively-decided actions that involve value judgments — that are inherently outside the scope of positive *or* normative economics. Therefore, what was initially a critique of economic theory has evolved into a critique of the theories of authors who use economics as the basis of their legal and political policy.²²⁶

f. Conclusion

In this section, I have outlined the aspects of theorists who rely on economic theory for their prescriptive framework. In doing so, I showed that these authors put forth views that are limited in the same way that economic theory is limited. In Parts II and III, I sought to expand the concept of merit goods from the economic to the legal realm. But even if a given theory cannot be *expanded* to include the concept of merit goods, I have shown that the authors’ own reasoning either requires it or already involves it implicitly.

Moreover, the purely economic way of thinking is not determinative of Supreme Court decisions that relate to an economist’s most inviolable right, private property. In this section, I demonstrated how various right-liberals predicate their political views on neoclassical economic theory. While it can be shown that these are implicitly merit goods arguments, there is one remaining task: to show how the theoretical framework must *necessarily* be expanded if they are to be complete, both theoretically and in terms of our reality.

V. A New Paradigm

²²⁵ See Hanson & Yosifon, *supra* note 70.

²²⁶ While I find the other critiques persuasive, one need not necessarily do so to accept merit goods. I do, however, believe that economics is of limited utility and has far outgrown its initial value.

Over the course of this Article, I have touched on themes in economic theory, Constitutional law, and political theory to build a case for the introduction of the concept of merit goods into the law. In this final section, I want to demonstrate the necessity of the concept and the means by which legal theory, left-liberalism, and right-liberalism can be enriched by the inclusion of this new concept.

a. Economic Theory and Political Theory

Section One showed a failing of economic theory at the point at which ethical decisions became necessary. While Musgrave and others provided various characterizations of the new concept of merit goods, I, tracking Ver Eecke's argument, have defined the concept broadly: a (de)merit good is one that public authorities, through a value judgment, determine should be consumed at higher (lower) than market rates. But how does this conceptual definition relate to law?

First, a wide variety of authors are strongly influenced by economics.²²⁷ But even these right-liberals make arguments involving merit goods reasoning. Whether we are discussing Nozick's "independent reasons" for a differentially beneficial rule, Buchanan's "fair game," Hayek's argument for a strong legal system, or Posner's decision to adopt utilitarian morals, every author makes ethical judgments in his theory. Moreover, the judgment involves an imposition that will *necessarily* make people worse off and might even leave society "worse off" on net.

Thus the case can be made rather easily that the authors surveyed make implicit merit goods arguments. But to make that claim, while important in clarifying terms, is not all that impressive; it simply gives a name to something that did not have a name to begin with. However, the problem runs deeper. Every single one of these authors treats the perfectly competitive, unregulated free market as a non-economic end. In this process, economics encompasses law, political theory, and ethics.

Earlier, an examination of the merit goods argument showed a failing of economic theory to adequately consider value judgments. If merit goods show the limits of economic theory, and if those limits are at the point of ethical decision-making, and these authors' theories involve some element of ethical decision-making, then these authors' theories must be limited in the same way that economic theory is limited.

Theory is a tool that empowers and disempowers. In the Introduction, I said that merit goods are patently illegitimate in mainstream economic

²²⁷ See Part III, *supra*.

theory. Insofar as these authors rely on mainstream economics for their political theories, the policies they advocate are illegitimate to them as well. This is true for positive legal economics (“economic analysis of law”) as well as for normative legal economics (which argues that utility-maximization *should* be at the heart of legal rules).

b. Our Constitutional Reality

True, the skeptical reader might admit, these authors’ theories involve implicit merit good reasoning. But what if we bracket off that portion of the theory? Everything else seems to remain intact. The theories are internally consistent and offer prescriptions for a wide array of other social policies upon which I have not even touched.

This objection is legitimate and deserves some consideration. After all, it is not exactly an achievement to show that the only failing of (say) Nozick’s theory is that he didn’t use the phrase “merit goods.” But again, that is just a symptomatic of a deeper problem. All of the theorists surveyed above employ value judgments at some point in their theory. If an ethical imposition is permissible to determine the rules of a “fair game” (as Buchanan might say) or to decide to adhere to utilitarian ethics (as Posner suggests), then why not in other situations?

We can make this question even stronger by observing a particularly salient example from our legal reality. Since 1887, the Supreme Court has ruled in a trend that strongly favors a rule of no compensation in regulatory takings cases. Indeed, Miceli and Segerson note that less than 10% of regulatory takings cases were ruled takings by state supreme courts and just one-third were so ruled by the U.S. Supreme Court.²²⁸ From *Mugler* to *Tahoe*, the Court has consistently ruled in a way that has never given complete and unequivocal weight to purely economic calculations of cost and benefit. In other words, even when the cases in question involve the taking of one’s private property — a fundamentally economic category — the courts have preferred a more comprehensive consideration that holds economic factors to be just one consideration among many others, including, but not limited to, the public welfare and morals.

Now the crack grows wider: if the courts have consistently favored the limitation of property rights on the basis of some other social “good,” then there are a large number of public policies that are outside the scope of

²²⁸ Miceli & Segerson, *supra* note 197, at 5. The time frame is 1990-1995 for state cases and 1979-1994 for U.S. Supreme Court cases. These time periods leave out the early twentieth century, when courts rarely even recognized regulatory takings. If they did, the percentages would be even lower.

these authors' theories. My contention is that it would be better to revise the theories in question to accommodate such developments. Of course, the instinctive response of purists is to move in just the opposite direction, insisting on the illegitimacy of merit goods and all property use limitations. But the reason for doing that is undercut, I believe, by a careful study of *what the proponents of such theories themselves already do in practice*. For the people who espouse such theories themselves routinely make implicit merit goods arguments *within* the context of their own theories. Whether they come out and say it or not, they know value judgments are unavoidable.

c. The Solution

Thus far I have identified shortcomings in economic theory and the strands of right-liberalism that place a high value on economic thinking. But we should be careful not to throw the baby out with the bathwater. Economic theory has tremendous explanatory power and it helps reduce complex problems to mathematical formulae. Right-liberalism (if somewhat tempered) enjoys widespread acceptance in the United States; the Lockean tradition strongly influenced the founding of the U.S. and is manifest in the Declaration of Independence and the U.S. Constitution. If economic theory and its derivative political theories fail at a given point, are they rendered useless?

Not necessarily. In framing my critique of economic theory, I am not challenging the unit of analysis (individuals), the assumptions underlying the models (rational self-interest), or the output of the models (empirical calculation of social phenomena).²²⁹ Similarly, in framing my critique of right-liberal democratic theory, I am not challenging the individualism, the bias against socialist or centralized planning, or the relative lack of concern with the outcome of the system. Instead, in both of these cases, I am demonstrating a limitation that occurs at one very specific point: when ethical decision-making must be introduced into economics.

This opens the door for policymaking that acknowledges value judgments. First, the economic system itself involves values imposition. Second, those authors who employ economic thinking implicitly acknowledge that their theories involve certain baseline values that must necessarily be imposed. Finally, our constitutional history indicates that even with regard to private property — the most fundamental economic right — value judgments and interference with preferences are permitted.

²²⁹ Others, of course, have leveled such broad critiques. See Hanson & Yosifon, *supra* note 70.

Merit goods are unique because they retain the foundations of economic theory while carving out a theoretical space to expand it — an expansion that comes in legal and political theory. While other political theorists (Mansbridge and MacIntyre, for example) level criticisms against economic theory as well, they do not do so from “within.” In *The Calculus of Consent*, Buchanan and Tullock write about the difference between economic theorists and political theorists:

When economic or market activity is observed to result in the imposition of costs on parties outside the exchange relationship, economists have tended to call attention to the “inefficiency” in over-all resource usage that this organizational arrangement generates. They seem rarely to have brought into question the morality or ethics of the individuals participating in such activity. . . . By contrast, the student of political [and legal] processes . . . has not considered the inefficiency aspects seriously. Instead he has . . . sought to accomplish reform through a regeneration of individual motives. Ethical and not structural reforms tend to be emphasized.²³⁰

The concept of merit goods bridges that chasm, and places the questions which economics is unable to answer in the realm of law and politics.

Merit goods are broadly applicable in legal theory. First, they provide a theoretical bridge by which the left-liberal can advocate economically suboptimal policies. For example, a Rawlsian map of primary goods can be considered to be merit good interferences in market processes. Ensuring that differences in society are arranged to benefit those who are worst-off can be considered another such merit good interference. But the second sphere of applicability of merit goods, the one on which I have focused in this Article, comes in right-liberalism and traditional law-and-economics. Right-liberalism need not be limited henceforth by the limitations of economic theory; by including the concept of merit goods, libertarian policies that were suspect (say, a commitment to free, compulsory public education) can be justified. Moreover, the right-liberal can expand her theory to include policies that were heretofore necessary but theoretically suspect. Many citizens of Haddonfield, NJ, we might say, are individualistic. Yet they espouse a policy that prevents the owner of a

²³⁰ Buchanan & Tullock, *supra* note 181, at 281.

building from renting office space to a lawyer if he wants to occupy a particular floor on a particular street. How can this be justified?

Washingtonians live and work minutes from monuments that honor men who believed firmly that individuals should determine their own ends. Yet a landowner in the District of Columbia cannot build whatever he wants within city limits; the Height of Buildings Act from 1899 prevents him. These are but a sampling of the other contradictions in public policy that abound in our culture. How can we resolve them?

In the absence of merit goods, a large number of *needed* policies are rendered suspect. And even if we reject those policies, economists' theories are themselves based on value judgments. Finally, even if we reject those theories, our constitutional reality endorses such value judgments. The merit goods concept resolves these inconsistencies and enriches these theories. Without the concept, right-liberals cannot account for interferences such as those mentioned throughout this paper, and left-liberals cannot justify their post-market objectives in market terms. While it is true that there need not be a dialogue between economics and politics, one cannot help but think that some such discourse is preferable to an argument in which two people are speaking past each other. In the Introduction, I wrote that economists, political theorists, and legal scholars are speaking different "languages." While the concept of merit goods may not be a Rosetta Stone, it certainly helps mediate among disciplines. It illuminates the value judgments inherent in policy and renders debate more intellectually honest. At its acme, the merit goods concept enriches legal, economic, and political theory. It provides a way to explain existing policy and helps bridge the gap between theory and reality.