7.1 Introduction

In the opening chapter, I defined merit-worthy in a manner which, while quite orthodox, masked the degree of disagreement which has characterised attempts to define the concept in a form useful to economists. As John Head put it in his retrospective of 1990:

As compared with social wants, however, the merit wants concept raises methodologically much more difficult and controversial issues symbolising as it does, for the public finance literature, many of the doubts and reservations which have been expressed over generations by economists of varying political persuasions regarding the ultimate normative authority of the consumer sovereignty principle. (p. 211)

One of the tasks of this chapter is provide an overview of alternative definitions of merit wants. Apart from various attempts to delineate the concept, the existing literature has been marked by two other features: its small size and the acknowledged lack of progress in formal modelling of the implications of the existence of merit goods for public policy. In part, the deficiencies of the policy literature arise from the absence of a good understanding of the psychology of economic behaviour. As a result, most of the writers on the subject have been content to assume that consumers systematically undervalue one (or more) goods, relative to the weight which would be placed on the merit good by a benevolent social planner. This approach has its uses. Policies based on tax incentives or direct allocation of the goods involved can be assessed without requiring a detailed examination of the source of the gap between preference and welfare. As a result, the tax-based models (e.g. Sandmo, 1983; Besley, 1988; Munro, 1992 or Racionero, 2000) probably give a good guide to the optimal use of taxes and provision in-kind. However, they cannot say much about the effect of alternative policy instruments, such as information provision nor how the policies ought to be framed. In addition, as long as the source of the difference between preference and welfare is unspecified then, unlike standard optimal tax models where estimates of elasticities and preferences can be employed to simulate optimal policy, models of merit want tax policy cannot be used to calibrate the optimal tax system.
A tour of most of the merit want cases is provided within Section 2 of this chapter. At various times in the lifespan of the concept, some examples of ‘merit wants’ have clearly trespassed on the other forms of market failure. For completeness, the more common of these examples are included here. The classification system used follows John Head’s taxonomy (see also Hillman, 1980 or ver Eecke, 2001) – at the individual level, separating out the rankings created by preference, choice and welfare, then, at the social level distinguishing between individualistic and non-individualistic social welfare functions.

### 7.2 Individualistic Welfare Functions, Private Failure

An individualistic social welfare function is one that depends only the individual welfare of the citizens who make up society. Thus it conforms to the neutrality property of Paretian welfare economics discussed in the Chapter 1.

In his classification of possible merit want arguments, Head begins with the distinction between preference and welfare. An operational definition of this distinction may not be possible, since both preference and welfare are potentially unobservable, but conceptually the idea is clear. As pointed out in Chapter 1, failures of preference and welfare to accord can be attributable to two kinds of problems: incoherent or incomplete preferences on the one hand or, on the other hand, mis-aligned preferences – which occur when individuals have complete and transitive preference rankings and choose according to them, but the preference rankings do not accord with their welfare counterparts.

Pigou (1920) was one of the first economists to point out one reason why preference may not match welfare: intertemporal choices may be distorted by our limited ability to imagine future consumption with the same intensity as the consideration of immediate gratification.

But this preference for present pleasure does not – the idea is self-contradictory – imply that a recent pleasure of given magnitude is any greater than a future pleasure of the same magnitude. It implies only that our telescopic faculty is defective, and that we, therefore, see future pleasures, as it were, on a diminished scale. Pigou (1920) 96–97.

As a result there would be a systematic tendency for the over allocation of resources to immediate gratification, compared to the allocation which would maximise welfare.

The possibility of intertemporal preferences which do not match welfare is of obvious importance in any discussion of pensions and savings, so my discussion of this concept is deferred to Chapter 10, but it is also the case that what may appear to be a gap between preference and welfare is in fact a gap between preference (which may accord with welfare) and choice, because of a failure of will (Baumeister 2003).

One of the main battlegrounds in debate over what constitutes a merit want has centred on the position of individuals who make choices based upon the wrong information. One view is that only choices made on the basis of full information can be viewed as welfare-maximising. Musgrave (1987) for instance, takes it as obvious