The Cultural Justification of Unearned Income: An Economic Model of Merit Goods Based on Aristolelian Ideas of Akrasia and Distributive Justice

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The chief objection to the most popular of all welfare precepts—equality of incomes—is not that it has no rigorously defensible foundations; the chief objection is that, even so far as tenable, it is completely uninteresting by comparison with the question of its effects upon cultural and economic evolution.

Joseph A. Schumpeter, History of Economic Analysis (1954, p. 1073)

Profit is usually justified by how it is earned. Thus the other papers in this volume discuss what entrepreneurs do, how they contribute to production, what they deserve, and the fairness of bargains. This paper, in contrast, justifies profits by how they are spent. Some activities are of greater cultural value than others. Disproportionate profits can be justified by disproportionate expenditure on valuable activities. Rehabilitating the cultural case for unearned income, which has lately fallen out of favor, is the object of this paper.

"Pure rent" refers to income obtained by owning something, not by doing anything. Pure rent exists only as a construct, because all forms of ownership require some minimal level of effort, risk taking, and management. Pure rent, however, is closely approximated by land rents from an inherited agricultural estate, or dividends from a portfolio of securities that the owner did not earn and does not manage. Since pure rent is unearned, its justification must be based upon how it is spent. Passive endowments sustain universities, foundations, and other institutions whose purpose is primarily cultural. The justification of the entitlement of these institutions to unearned profits must rest on the value of the activities in which they engage.

For many centuries, economic rent was defended philosophically by drawing on Aristotelian ideas about cultural excellence. When these ideas lost favor, the cultural case for inequality fell into disrepute. We argue that these Aristotelian ideas fell from favor for reasons that have little to do with their merits. They must be resurrected in some form if we are to make sense of cultural values and explain the role of universities or foundations.
Cultural Justification of Unearned Income

The idea of cultural excellence survives in economic theory through the vestigial concept of merit goods, which we explain and criticize. To make sense of merit goods, we model "akrasia," which occurs when a less worthwhile activity is chosen in preference to one the decision maker knows is more worthwhile. We conclude that although democracies are rightly suspicious of arguments for inequality, merit goods have their place even in a democracy.

**Liberal and Illiberal Activities**

We begin by sketching general features of the Aristotelian conception of property that we will defend. Aristotle believed that some human activities are more worthwhile than others. Consequently, he could analyze the value of consumption, or, as he put it, the value of having external things, by asking about the value of the activities that these things make possible. Aristotle divided activities into two broad groups according to whether their value is intrinsic or instrumental. "Liberal" activities are worth doing for their own sake, independent of any further end to be achieved. Examples are athletics, poetry, and philosophy. Other activities are worthwhile as means to intrinsically valuable activities. These "illiberal" activities are engaged in only for the sake of their effects. Examples are bricklaying and medicine, which would vanish if some technological advance permitted us to have houses and health without these trades, just as the cooper, fletcher, blacksmith, and wainwright have vanished.

In one sense, the illiberal activities are the most fundamental. Without food, shelter, and clothing there could be no liberal activities or, indeed, any human life. Illiberal activities are necessary and useful. In another sense the liberal activities are the most fundamental because they are worthwhile in themselves. Just as the instrument is inferior to the purpose it serves, so the illiberal activities are inferior to those which are "liberal or noble," according to Aristotle.

Moreover, Aristotle held that political arrangements should reflect the superiority of liberal activities, because "political society exists for the sake of noble actions, and not of mere companionship." In particular, property arrangements should reflect the fact that having things permits or facilitates doing things that are intrinsically good. Since any activity is best performed by people with talent and dedication, those with the greatest capacity and dedication for

2. Ibid., 8.2.1337b, 8.3.1338a–38b.
3. Ibid., 8.3.1338a.
4. Ibid., 3.9.1281a, 7.1.1323a–24a, 7.8.1328a.
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liberal activities have a legitimate claim to the resources these activities require. Therefore, disparities in the value of actions ultimately justify disparities in wealth and power.

REJECTION OF THE CULTURAL CASE FOR INEQUALITY

We think these ideas are worth taking seriously, and we will be exploring their implications in this chapter. We acknowledge that to many people today they may seem strange or wrong. It will be helpful to consider in advance why people think so.

The most obvious reason is that, as citizens of a democracy, we must be cautious toward claims that some people have a greater capacity and desire to engage in worthwhile activities than others. Cultural elites endanger democracy in much the same way as powerful central government. Too much of it, and there will be no democracy. True as that may be, however, we should ask ourselves whether some people have more capacity and dedication to worthwhile activities than others. If they do, then current attempts to ground political theory on the denial of this fact endanger democracy by building a falsehood into its foundation.

Aristotle warned of this danger:

In democracies of the more extreme type there has arisen a false idea of freedom which is contradictory to the true interests of the state. For two principles are characteristic of democracy, the government of the majority and freedom. Men think that what is just is equal; and that equality is the supremacy of the popular will; and that freedom means doing what a man likes. In such democracies every one lives as he pleases, or in the words of Euripides, "according to his fancy." 5

This false idea of freedom endangers democracy, according to Aristotle, by confusing the actions in which "democrats delight" with those by which "democracy is made possible." 6 Democrats may delight in saying that freedom is doing what one likes, but democracy may be better preserved when citizens are educated as far as possible to do what is genuinely worthwhile. Democracy may be better preserved when its citizens appreciate the contribution that elites can make within a democracy. In any case, one can love democracy without believing that freedom only means doing what one likes.

A second reason why Aristotle's ideas inspire distrust is because European ruling elites once invoked them to defend their privileges. Liberal activities

5. Ibid., 5.9.1310a.
6. Ibid., 5.9.1310a.
can only be done, or can best be done, by people possessing independence, education, and the leisure to pursue them. These attributes are conferred by rents from owning valuable property. The upper classes claimed that they were, therefore, entitled to their property. In the novel War and Peace, Andre complains to Pierre that his scheme to educate the peasants will give them "my tastes without my income." This quip suggests that the proportion of income spent on culturally superior goods rises with the amount of income, or, in technical terms, merit goods are superior goods. To the extent that this is true, the cultural argument figures in the justification of inequality in general.

In Aristotle's terminology, however, this older European society was oligarchic rather than aristocratic. In both aristocracies and oligarchies, an elite has an unequal share of wealth and power, but membership in the elite is determined on different grounds: in an oligarchy, by birth or wealth; in an aristocracy by ability or merit. Aristocracy is a legitimate form of government, according to Aristotle, but oligarchy is not.7

It is perverse to use aristocratic arguments to defend oligarchy, but, as Aristotle himself pointed out, to do so is quite understandable. "The best shall have more" sounds more like a moral principle than "them as has [or had] gets." Also, just as Aristotle warned that democracy could be destroyed by a false idea of freedom, he warned that oligarchy was threatened when "the sons of the ruling class in an oligarchy live in luxury."8 To keep its power, an oligarchic elite should train its children in moral and intellectual virtues and so make itself respected. In that way the oligarchy becomes something like an aristocracy even though the basis of its power is still wealth or inherited status. Members of the elite families in Europe were expected to possess education, courage, honor, and justice not demanded of others. That is one reason they held power as long as they did.

Nevertheless, there was tension between the demands of the aristocratic principle and the reality of the older European societies that claimed to be based on it. The activities deemed "aristocratic" had to be simultaneously within the capacity of those who happened to be born into elite families and beyond the capacity of those born outside them. The result was the sort of behavior Veblen ascribed to a leisure class. (Veblen 1919, pp. 75–85; Elias 1983, pp. 62–67). Activities were deemed "aristocratic" because they were most easily acquired through training in childhood (such as polished manners and facility in foreign languages) or because they demanded large expenditure of wealth (such as horsemanship, opera, and balls).

7. Nicomachean Ethics 5.3.1131a; Politics 3.7.1279a–79b, 4.5.1292a–92b, 4.7.1293a–93b. 8. Politics 5.9.1310a.
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Writers, artists, and other culture heroes were patronized by the elite but never quite belonged to it. Writers said they belonged to a separate society, the "republic of letters." Even so, they had to write slavish introductions dedicating their works to wealthy persons, and they had to mind their manners. When Voltaire did not, and was beaten by the servants of a nobleman he had offended, he discovered that none of his noble friends would help him. Just as we can love democracy without subscribing to what Aristotle called a false idea of freedom, so we can dislike the older oligarchy without rejecting the cultural ideals it used for camouflage.

While the founders of the American republic were not in general Aristotelians, they did not regard all activities as equally wise and virtuous, or believe that virtue and wisdom were equally possessed by all citizens. According to John Adams,

although there is a moral and political and a natural Equality among Man-kind, all being born free and equal, Yet there are other Inequalities which are equally natural. Such as Strength, Activity, Genius, Talents, Virtues, Benevolence.9

His great adversary, Thomas Jefferson, agreed. In a letter he wrote to Adams toward the end of his life, he said,

I agree with you that there is a natural aristocracy among men. The grounds of this are virtue and talents. . . . May we not even say that that form of government is the best which provides for a pure selection of these natural aristoi into the offices of government?10

Their disagreement, according to Jefferson, was that Adams believed that getting such people into office required strengthening the wealthy, whereas Jefferson believed that the people could be trusted to elect the virtuous and talented. It would be surprising if principles that both Jefferson and Adams agreed upon were antithetical to the Republic they founded.

Another and more profound reason for dismissing Aristotle’s ideas is that they depend on a metaphysics rejected by modern philosophers. This metaphysics gave him a reference point for comparing the value of different activities. According to Aristotle, every living thing has an "end," which is what it does when its powers and faculties are developed fully and harmoniously. The end of a frog is the way it lives in an environment in which it can develop all the capacities of a frog. Similarly, the end of man is a distinctively human

life in which the unique capacities of the species are fully developed and employed. This ultimate end belongs to man because of the kind of creature he is. Like the frog, man does not choose his ultimate end, but unlike the frog, man can recognize it.  

The distinctively human capacity that separates us from other creatures is reason.  

Man can understand his end and choose those actions that contribute to it. Illiberal actions contribute to man’s end instrumentally, by making liberal actions possible. Liberal actions are valuable in themselves because they express man’s distinctively human capacities. Furthermore, man becomes vicious when he chooses activities, not because they are intrinsically valuable or instrumental to intrinsic value but on the basis of impulses that run contrary to reason and to man’s end.

Aristotle believed there is a hierarchy even in liberal activities, the most valuable being expressions of man’s distinctively human capacity to know and to direct his action by what he knows. To understand the most fundamental and universal principles concerning the world is the highest form of knowledge. Consequently, Aristotle considered metaphysics, which studies all reality, to be more valuable than sciences which study only particular aspects of it. The highest object that reason can have when it directs action is to procure the greater good for all the citizens. Consequently, Aristotle considered politics to be more valuable than instrumental reason serving private ends. Thus, while Aristotle recognized different ways in which actions can be more or less valuable, the reference point for determining their value was the ultimate end of man.

Modern philosophers reject the idea that man’s ultimate end can be discovered by observing what is distinctive about the human species. By that logic, why not say that man’s ultimate end is walking erect on two legs? Why not define man as a featherless biped rather than a rational animal? Discrediting the classical metaphysics undermined the confident belief in hierarchical values. Lacking such a reference point, modern philosophers try to discuss value without making any judgments about the merits of engaging in one activity rather than another. As John Locke said,

The philosophers of old did in vain inquire whether the summum bonum consisted in riches, or bodily delights, or virtue or contemplation; and

11. See Parts of Animals 1.1.639b–40b; Nicomachean Ethics 1.7.1097b–98b.
13. Metaphysics 1.2.982a–82b; Ethics 10.7.1177a–77b.
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ey might have as reasonably disputed whether the best relish were to be found in apples, plums or nuts.\textsuperscript{15}

The result, very often, has been political theories which begin by assuming no activity is more worthwhile than any other, and end by paying particular respect to the values of liberty and equality. This approach entails a limited and negative notion of freedom and equality. For Aristotle, freedom in the broad sense means the ability to do those things that are worthwhile. Equality means distribution of goods according to what people need for what they are to do. A democracy aims for freedom and equality so that each citizen can do what is worthwhile, not because there is nothing worthwhile to do. The idea that freedom means doing whatever one pleases was, for Aristotle, the false concept of freedom that can destroy democracy. For much of modern philosophy and political theory, however, it is the only possible concept of freedom.

There are, indeed, major problems concerning the validity of Aristotelian metaphysics, problems that we cannot deal with here. Despite these problems, few people really doubt that some activities are more worthwhile than others. Few people teach their children that choosing between riches and right conduct, or between sensual gratification and study, is like choosing between apples and plums. If modern philosophy cannot explain why some activities are more worthwhile than others, so much the worse, in our opinion, for modern philosophy. Without committing ourselves to Aristotle's metaphysics, we will go on believing that some activities are more worthwhile in much the same way we will go on believing in the existence of the external world whether or not philosophers can give us a reason for doing so. We can ask ourselves how in a democracy everyone can have the opportunity to do what is worthwhile, and what role, if any, elites could play in the process. If we are to ask these questions, however, we will not only have to break with certain trends in modern political theory but rethink the foundations of modern welfare economics.

The Foundations of Welfare Economics

The elements of the formal theory of value in contemporary economics are deceptively simple: a rational person can rank states of the world from bad to good. The real numbers can be ranked from small to large. Therefore, better states can be associated with larger numbers. By this association, the problem of making the best available choice is recast as the problem of finding the largest attainable number.

Cultural Justification of Unearned Income

The mathematics of optimization is purely formal because it concerns the satisfaction of preferences, whatever they happen to be. In contrast, a substantive theory of value must say something about the content of preferences, not just their form. In economics there are two intertwined traditions concerning substantive values. First, according to the utilitarian tradition, the value of something is the total pleasure that individuals obtain from it. The pleasures enjoyed by an individual are added to yield his individual utility, maximization of which is his putative objective, and the individual utilities are added to obtain the total utility for society, maximization of which is the putative goal of public policy. Second, according to the market tradition, the value of something is the total amount that individuals are willing to pay for it. The prices people are willing to pay for the goods they enjoy can be added to compute the wealth of the nation, maximization of which is the market economist’s goal.

Should value be measured by pleasure or price?16 The policy issue that divides the two schools in economics is income redistribution. Utilitarians assert that the value of wealth is the pleasure it affords to people. Material needs are felt so keenly that a poor person allegedly obtains more pleasure from an additional dollar spent on necessities than a rich person obtains from an additional dollar spent on luxuries. To illustrate, Pigou thought that a person has a hierarchy of needs that must be fulfilled by working from the bottom up. The baser needs at the bottom are “material,” such as food, shelter, and clothing. The nobler needs at the top are immaterial, such as cultural entertainment. The “material welfare school” of economists thought that expenditures to satisfy material needs yield greater pleasure (or alleviate more pain) than equal expenditures to satisfy immaterial needs. For example, the sum of utilities can be increased by transferring a dollar of expenditure from opera tickets for the rich to bread for the poor. This line of reasoning provided a utilitarian foundation for redistributive policies, such as progressive income taxation and socialized medicine.

In contrast, market theorists assert that, since wealth is the final measure of value, economists can say nothing about its value. In particular, they can say nothing about the value of wealth to different classes of people. The claim that the poor need bread more than the rich need opera tickets does not belong in economics, according to the market theorists, because it is unscientific. A dollar is worth a dollar, whether it is spent on bread or opera tickets. Public policy should aim to maximize wealth without regard to its use.

16. These arguments are developed at greater length in Cooter and Rappoport (1984).
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Formal economic theory assumed its modern character with the marginalist revolution in the second half of the nineteenth century. The crucial step was combining utilitarianism and calculus to produce decision theory ("the calculus of utilities"). This step initiated the elaboration of the mathematical techniques that are central to modern economic theory. Interpretation of the new mathematics diverged over income redistribution. Utilitarianism developed into the material welfare school, which favored government policies to redistribute wealth. Some of its leading figures, including Pigou, were associated with the emerging socialist movements in the early part of the twentieth century.

The material welfare school was almost swept away in Anglo-American economics in the 1930s by market economists. The views of the market economists were organized in a movement often called the "ordinalist revolution." The ordinists acknowledge that each rational individual has a preference ordering that expresses his private values. Pleasures and satisfactions are allegedly not observable in the way required to compare between persons. Consequently, the ordering of different people cannot be combined together in any compelling way to yield public values. In contrast, market prices are public and wealth is observable. The best public policies are, consequently, those that give the individual the greatest liberty and wealth to satisfy his private preferences.

Subordination of Merit Goods

Aristotle's belief that democracies can pursue cultural excellence while committed to liberty and equality is expressed concretely in the history of economics. To tell the story, we must return to the disagreement between utilitarian and market economists. These two schools are joined in a lively debate over income distribution that provokes sharp barbs and yields valuable insights from time to time. The joining of debate is facilitated by agreement upon common assumptions requiring no discussion. One common assumption is that the value of pleasure or wealth is determined by its quantity, not its causes or uses. Consequently, no activities are intrinsically more valuable than others.

For example, Jeremy Bentham, the first systematic utilitarian, held that the satisfaction or pleasure or utility that people get through their choices is equally valuable regardless of the activity that produces it. Thus the belief that the pleasure of poetry is more valuable than the pleasure of dominoes is viewed by Benthamites as a mistake in understanding the metric, rather like thinking

17. This section draws upon Cooter (1990), which appears in a symposium on merit goods. Also see the other articles in the symposium.
that a pound of gold weighs more than a pound of clay. Indeed, the elaboration of Bentham's theory led to the conclusion that base goods are more important for economic policy than noble goods, because a dollar spent to satisfy material needs yields more pleasure than a dollar spent to satisfy noble desires.

Notice that utility theorists and market theorists agree that value attaches exclusively to individuals, either in the form of pleasures they enjoy or prices they are willing to pay. Thus the value of an institution or organization is merely the aggregation of its value to affected individuals. Bentham expressed the point succinctly: "The interest of the community then is, what?—the sum of the interests of the several members who compose it" (Bentham 1948, p. 3). An alternative assumption is that some values cannot be reduced to pleasures of individuals or the prices they are willing to pay. Standards for value distinct from individual preferences are needed to make sense of the Aristotelian ideas of cultural excellence, liberal activities, and hierarchies of goods.

When modern public finance began to emerge in the 1940s and 1950s, much effort was devoted to drawing the proper boundary between the public and private sectors. A seminal thinker about this problem was Richard Musgrave. Musgrave distinguished the public and private sectors in part on the basis of the distinction between public goods, such as military security, and private goods, such as apples. One person's consumption of a private good reduces the quantity available to others. Furthermore, the legal institution of private property enables one person to exclude others from consuming his private goods. In contrast, one person's enjoyment of a public good does not diminish another's ("nonrivalry"), and excluding some people from enjoying the good is difficult or impossible ("nonexclusion"). Government must determine the supply of public goods, according to Musgrave, because the market will undersupply them. In contrast, the market should determine the supply of private goods, because it can do so more efficiently than the government, although Musgrave allows that government may redistribute private goods for the sake of equality.

Musgrave noticed that the public-private distinction seemed to leave out an important class of goods that governments often supply, such as cultural events and liberal education. He described these as "merit goods," because they are valued by a cultural tradition that transcends individual preferences. Thus Musgrave opened a crack for excellence to slip into the debate over equality and liberty.

Merit goods require modification of the mathematical model at the core of

18. A symposium on Musgrave's ideas is in the edited volume by Brennan and Walsh (1990). For a complete bibliography of Musgrave's writings on this topic, see ibid., p. 252.
the economic theory of value, which provides insight into their character. The allocation of goods in the economy is represented by a vector $X = (X_1, X_2, \ldots, X_m)$. The degree to which the preferences of the $i$th individual are satisfied is indicated by the variable $U_i$, which is a function of the allocation of goods: $U_i = U_i(X)$. The preference satisfaction of all individuals $1, 2, \ldots, n$ in society is represented by all the utility functions denoted $(U_1, U_2, \ldots, U_n)$. According to conventional economic theory, a social ordering $W$ is a function of the satisfaction of individual preferences: $W = W(U_1, U_2, \ldots, U_n)$. $W$ is strictly individualistic in this formulation because its value depends exclusively on the level of individual satisfaction. According to the conventional conception, social choices should maximize a measure of value $W$ that is reducible to individual values.

To represent irreducible social values, the social welfare function $W$ must be modified so that it does not depend exclusively upon the satisfaction of individual preferences. If some goods have merit (or demerit) that is not merely due to their capacity to satisfy individual preferences, social welfare can be approximated better if these goods enter the social welfare function directly. Denote these goods $X_k \ldots X_m$. The revised social welfare function is rewritten in the form $W = W(U_1, U_2, \ldots, U_n; X_k \ldots X_m)$. Thus the satisfaction of individual preferences $U_1, U_2, \ldots, U_n$ receives weight, but merit goods $X_k \ldots X_m$ receive weight in their own right. The revised social welfare function $W$ depends upon irreducible social values because it does not depend exclusively on individual values. By maximizing revised $W$, social decisions are guided by a weighted combination of individual and social values.

The next step is to apply calculus to derive the conditions for an optimal allocation of merit goods. According to these conditions, a private good or an ordinary public good should be supplied until the price people are willing to pay for it equals its cost of production. In contrast, the supply of a merit good must be increased beyond this point in order to reflect its irreducible social value. At the optimum, the cost of merit goods equals the sum of their irreducible social value and the amount people are willing to pay for them (Cooter 1990).

To illustrate the use of this formulation, consider an example from Mill (1950). Pleasures, in Mill's opinion, differ according to their quality. Thus poetry affords a higher quality of pleasure than pushpin (a mindless bar room game, the "pacman" of nineteenth-century England). Even if poetry yields the same quantity of pleasure to one person as pushpin yields to another, the former should receive more weight in the social calculus than the latter. For Mill, poetry is a merit good whose value exceeds some peoples' actual prefer-
ences for it. The implication, according to the mathematical formulation, is that resources should be allocated to producing poetry in excess of market demand. In fact, the production of poetry in most countries enjoys subsidies from a variety of public and private sources, especially through free education, whereas no one subsidizes pushpin.

The mathematics in effect defines merit goods by the fact that their value to society exceeds their value to individuals. Their intrinsic value tilts the optimal allocation of resources in their favor and calls for a subsidy. The subsidy is a wedge between the cost of a good and the amount people are willing to pay for it.

A wedge between cost and willingness to pay is not unusual in conventional economics, but merit is not the conventional cause. Rather, the conventional cause is the consumer’s ignorance about the good’s qualities, or the presence of externalities like pollution. These sources of market failure offer no challenge to individual values because the optimal size of the wedge can be computed in such circumstances by the standard techniques of cost benefit analysis. In contrast, the size of the appropriate wedge for merit goods cannot be computed by cost benefit techniques.

**A Model of Akrasia**

The preceding formulation captures the idea that the intrinsic value of goods can exceed the amount people are willing to pay for them. Unfortunately, the formulation does not suggest how intrinsic value is determined. Is intrinsic value completely independent of individual preferences? If so, how can it express itself in observable behavior? Or does intrinsic value depend upon the preferences of privileged persons, such as the philosopher-king, the cultural elite, or the National Endowment for the Humanities?

To answer such questions, we will develop a formalization which is more adequate to the tradition of Aristotle. We will begin by considering a problem that arises when a person perceives that one activity is more worthwhile than another. The problem is that the person may be drawn to the less valuable activity in spite of his knowledge of its character. "Akrasia" is Aristotle’s term for acting on impulse by choosing an activity that the decision maker knows to be less worthwhile than an available alternative.

The problem of akrasia is not one with which contemporary economic

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Figure 1: Decision tree.

theory finds it easy to deal. Decision makers in economic theory possess preferences and information. Rationality consists in making decisions that maximize the expected satisfaction from available opportunities. This simple model of decision making does not encompass conflicting motives. It has no scope for tension between one desire and another. It offers no account of how or why a person might vacillate between alternatives when deciding what to do, or regret what he did.

We will try to formalize "akrasia" and apply our model to the problem of choosing liberal actions. The simplest form of akrasia concerns the control of impulses, such as the urge to overeat or drink to excess. Balancing immediate impulses against future considerations is modeled in economics by time discounting. We model akrasia as time discounting and then extent the model to cultural values.

The conflict between immediate impulse and future interests is reduced to its simplest elements in the decision tree in figure 1. The decision-maker's preferences toward futurity are probabilistic, depending upon mood and circumstances. At the first branching of the tree, the actor draws a subjective discount rate, denoted \( r_0 \), from a probability distribution, denoted \( p(r) \). At the second branching, the decision maker chooses between consuming one unit or investing it. After the decision to consume or invest is made, the decision maker once again draws a discount rate \( r \) from the probability distribution \( p(r) \). Finally, the investment yields benefits \( b \) at the terminus of the decision tree.

Figure 1 poses a dilemma because it is not clear what discount rate should
be used when deciding whether to consume or invest. Economists beginning with Strotz have investigated the problem of consistency in preferences over time. General solutions have been proposed for problems involving "multiple selves." A simple representation seems best for our purposes, even though mathematical elaboration will, no doubt, reveal its implicit limitations.

One possibility is to act on impulse. An impulsive decision maker would compare the value of consumption to the present value of investment, which is computed using the discount rate $r_0$. Another possibility is to act on considered preferences. A prudent decision maker would compare the value of consumption to the possible future values of investment, which are computed using the possible discount rates $r_1$. The difference between the two ways of deciding will be characterized formally.

First we explain the calculation of an impulsive decision maker. The value of consumption equals 1 in figure 1. The present value of investment at the moment of choice in figure 1 is computed by using the actual discount rate $r_0$ that was drawn at the first branching of the tree:

$$PV(r_0) = b/r_0.$$ 

The amount by which the dollar value of consumption exceeds the present value of investment measures the strength of the impulse to consume, denoted $M$:

$$M(r_0) = 1 - PV(r_0).$$

An impulsive decision maker would follow this rule:

$$M(r_0) > 0 \quad \iff \quad \text{consume}$$

$$M(r_0) < 0 \quad \iff \quad \text{invest.}$$

Now we consider the calculation by a prudent decision maker who acts upon considered preferences. A prudent decision maker compares the value of consumption to the present value of investment as discounted at each of the possible rates $r_1$. To arrive at a single number for the present value of investment, the possible rates must be weighted and combined. A good way to proceed is to weight each discount rate $r_1$ by its probability. Proceeding in this way, we arrive at the following formulation for the expected present value of investment:

$$E[PV(r)] = r_0 \int p(r) PV(r) dr$$

$$= \int p(r) b/r dr.$$
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The difference between the expected present value of investing and the dollar value of consuming measures the expected regret from consuming, denoted $ER$:

$$ER = E(PV) - 1.$$ 

A perfectly prudent decision maker would follow this rule:

$$ER < 0 \quad <=> \quad consume$$
$$ER > 0 \quad <=> \quad invest.$$ 

This rule instructs the decision maker to consume only if its value exceeds the expected present value of investing.

As explained, the decision maker may act on immediate preferences $r_0$, or the distribution of future preferences $p(r)$. The first decision rule gives all the weight to immediate impulse, and the second decision rule gives all the weight to considered preferences. Most decision makers give some weight to each. A little more formalization will allow us to characterize the weighting that a decision maker gives impulse satisfaction and expected regret.

Let the decision-maker's weighting of impulse and regret be represented by a decision function $U$:

$$U = U[M(r_0), ER].$$ 

Think of $U$ as an ordinal preference function that is increasing in impulse satisfaction $M$ and decreasing in expected regret $ER$. If the former is strong relative to the latter, the decision maker in figure 1 will consume. Otherwise he will invest.

For simplicity's sake, normalize $U$ so that impulse prevails over deliberation for positive values, and vice versa for negative values:

$$U > 0 \quad <=> \quad consume$$
$$U < 0 \quad <=> \quad invest.$$ 

This decision rule is depicted in figure 2. The indifference curve $0 = U$ bisects the space into areas of consumption and investment. To interpret the graph, consider starting from any point on $0 = U$, such as $(M_0, ER_0)$, and moving in various directions. A move to the northwest represents an increase in impulse satisfaction and a decrease in regret, so $U$ increases. A move to the southeast represents less impulse satisfaction and more regret, so $U$ decreases. A move up the indifference curve $0 = U$ represents an increase in impulse satisfaction and an offsetting increase in expected regret, so immediate behavior does not change.
For each decision maker, there will be a tipping value of $r_0$, denoted $r^*$, which is defined by

$$0 = U[M(r^*), ER].$$

A particular decision maker with preference $U$ will thus follow his impulse when he draws a discount rate $r_0$ such that $r_0 > r^*$, and he will follow his considered preferences when he draws a discount rate $r_0$ such that $r_0 < r^*$.

$$r_0 > r^* \iff \text{consumes}$$

$$r_0 < r^* \iff \text{invests}.$$

The tipping point $r^*$ divides the probability distribution $p(r)$ into zones of consumption and investment, as illustrated in figure 3.

The value of $r^*$ for a particular decision maker measures his strength of will. The higher is the value of $r^*$, the stronger is the will of the decision maker. When the decision maker's will is strong, the zone of consumption in figure 3 is small and the zone of investment is large.

Economics has long entertained the possibility of "preferences over preferences" (Lancaster 1958; Harsanyi 1955). We have in effect extended these models to include conflict between preferences. The model just presented departs from conventional economics by permitting the decision maker to recognize conflicting motives and to weigh them against each other. For example,
the decision maker may say to himself, "I feel like watching television, but it would be better to read a book." To make matters simple, we described his conflicting preferences as operating at distinct moments in time. He can recognize now that his current preferences may not be those he will have in the future. He can read the book tonight because he thinks he may regret having watched television instead.

ORGANIZING FOR EXCELLENCE

We have developed a model of akrasia in which an individual decision maker weighs his immediate impulse and his considered judgment. Our next task is to proceed from individual choice to collective choice and connect akrasia to theories of property and distribution. We will consider why cultural activities might be supported by political decisions, such as government subsidies, tax deductions for donations to the arts or the appreciated value of donated artworks, or laws like the California Art Preservation Act of 1980 that restrict the removal or destruction of artworks. We will argue that private donations to cultural activities, which provide subsidies for merit goods by decentralized, voluntary means, are less problematic in a democracy than state subsidies.

According to the Aristotelian tradition, the dominant principles of resource allocation in a democracy must be equality and liberty. But these principles will be diluted and modified in practice. Modification is required, first, because of their internal conflict due to the fact that freedom in the economic sphere naturally generates inequality. Second, preserving incentives for savings, investment, and risk-taking require unequal wealth. If resources were distributed
equally, the incentive to work and invest would be lost, and everyone would become poorer. 20

The concern of this chapter, however, is with a third reason for modifying democratic principles: the intrinsic superiority of some activities over others, which requires channeling resources to merit goods. Cultural excellence requires the subsidy of liberal activities by private donors or the state. To isolate this issue, we assume away most questions of incentives and focus upon pure rent. By definition, pure rent is income obtained purely from owning property. Our problem is to characterize mechanisms for allocating pure rents to achieve cultural excellence.

**Collective Choice by Identical People**

We begin by considering the simple case in which everyone is alike. We assume that they have equal capacities for liberal and nonliberal activities and equal propensities to akrasia. There are no elites. In terms of the formal model, we are assuming that everyone has the same decision function $U$, so that $r^*$ is the same for everyone. Furthermore, everyone is assumed to draw from the same probability distribution $p(r)$, so that everyone's expected consumption and investment is the same.

Under these assumptions, everyone would have an equal capacity to choose, and the individual himself would best know the circumstances under which he is acting. Consequently, democracy's principles of equality and liberty commend providing everyone with the means to pursue liberal activities and allowing everyone the liberty to choose his activities for himself. In such a society, there would still be reasons for deviating from the principles of liberty and equality on occasion. Some of these reasons have to do with the amount of economic resources necessary to carry on different activities. The theoretical mathematician needs a pencil, the violinist needs a violin, and the physicist needs a particle accelerator, so the resources that they receive cannot be equal. 21 The principles guiding this unequal division would need to be worked out.

Even under these assumptions, however, there is another reason for deviating from the central principles of a democracy, one that figures prominently in this article. People may wish to tilt the scales, or alter market prices, in favor of liberal activities. One way is by personal commitment. For example, the decision maker may decide not to buy a television, so that he cannot

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20. See Politics 2.5.1263a–63b, 5.8.1309a.
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succumb to the temptation to watch it. Or a person may wish to donate to the theater, so that tickets will be cheaper for everyone.

Personal commitments can be made without collective choice. Suppose, however, that some kinds of commitments can only be made collectively. For example, suppose that a town is considering whether to make cable television available to households. The town might exclude cable television altogether, or it might exclude culturally worthless programming. Similarly, it takes a collective decision to preserve the natural beauty of the California coastline or to create the artistic beauty of a renaissance Italian city. Choice is forced into the public domain in such cases because of increasing returns to scale, as in the case of cable television, or public merit goods, as in the case of the California coastline or the renaissance city. The technical consequences of increasing returns to scale and public goods have been extensively analyzed in microeconomics, and the political aspects of public sector behavior have been extensively analyzed in collective choice theory. Instead of recapitulating familiar theories, we turn to novel considerations raised by our model of akrasia.

The model of akrasia suggests that even a rational person occasionally experiences powerful impulses that can lead to future regret. Given this fact, the rational person provides in advance against occasions when dangerous impulses are strong. The classical example is Ulysses tying himself to the mast in order to resist the Sirens’ song. Game theorists describe such devies as "commitments." Collective choice can be a rational commitment on the part of individuals not to succumb to their worst impulses, as we will explain.

Suppose that most people prefer more worthwhile activities most of the time. In formal terms, the density of the probability function \( p(r) \) in the region below \( r^* \) exceeds the density above \( r^* \). Under that assumption, the conduct of the more worthwhile activities will win a majority in a vote. Taking choice away from individuals and relegating it to majority rule in these circumstances is a form of commitment to excellence. This kind of rationale could be given for the decision to subsidize education or theater. Everyone might want subsidies to overcome the impulses to scrimp on their children’s education or to stay home and watch television.

This justification for collective action is premised upon the proposition that the average preferences of people are similar to their considered judgments. Collective choice in democratic assemblies is made by a process intended to produce considered judgment, such as public debate and the requirement of concurrence in two houses of the legislature. As Aristotle said,
the many, of whom each individual is but an ordinary person, when they meet together may very likely be better than the few good, if regarded not individually but collectively, just as a feast to which many contribute is better than a dinner provided out of a single purse.\textsuperscript{22}

This argument for collective choice has not been captured previously in formal economic theory. It is, however, similar to the well-known result that majority choices are superior to individual judgments when everyone agrees on the evaluative standards and everyone receives information with a random error term.

\textbf{Collective Choice by Different Kinds of People}

The preceding argument assumed that everyone is like everyone else, including being susceptible to the same impulses. As long as this is true, everyone’s considered judgment is the same, so collective choice will be unanimous and state subsidies involve no coercion of dissenters. Under these circumstances, state subsidies of worthwhile activities are a form of personal commitment.

A more difficult and realistic case is one in which peoples’ considered judgments are different. In technical terms, we are assuming that people have different decision functions $U$, so they have different tipping points $r^*$. Under these assumptions, collective commitment differs from personal commitment. With personal commitment, a person’s better self coerces his worse self. With collective commitment to merit goods and a heterogeneous population, some people’s better selves coerce their own worse selves and other people.

People who insist that their cultural values are better than others’ must advance such claims with great caution in a pluralistic democracy. To help us think about this difficult problem, let us imagine a society consisting of three classes. One class is a cultural elite, composed of people who have a superior capacity to engage in liberal activities. The second class is an economic elite, who have greater wealth and income-earning ability. We will assume that membership in these two groups does not overlap greatly, and that the two together comprise a minority of the population. Finally, the third class is the majority of citizens who are not distinguished by wealth or culture, but whose numbers gives them control over democratic politics. The three classes of people are the best, the rich, and the many. That was much the way Aristotle

\textsuperscript{22. Ibid., 3.11.1281a–1281b.}
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saw the world, or, for that matter, the way Jefferson described it in his letter to Adams.

One can describe the relationship among these three classes by drawing on the model of akrasia. People always tend to think that the activities that they like, do best, and best understand are the most important. The average citizen is likely to think that the most important activities are those familiar to him, activities which are within the reach of everybody. The rich are likely to think that the most important activities are those requiring personal wealth. Thus, as we have seen, the oligarchs of earlier European society prized activities that require either a great deal of money or an upperclass education in one’s early years. Similarly, those who spend their lives engaged in liberal activities will think them the most important.

In deciding what is worthwhile, three classes of people draw their preferences from three different distributions. The preferences anyone draws can diverge from the truly desirable, but members of the three groups are not equally likely to diverge, or to diverge in the same direction. To the extent that the best are true aristoi, the mean of the distribution from which they draw is closest to the truly desirable. The distribution from which the rich draw will deviate from the truly desirable in the direction of those activities that cost money. That of the majority will deviate in the direction of those activities familiar to everyone.

It is possible for each group to recognize its own proclivity to deviate and to correct its behavior accordingly. This possibility is suggested by Voltaire’s report that the English gave Isaac Newton the funeral procession of a king, even though neither the poor who watched nor the rich who participated understood much about his discoveries. For the majority or the rich to choose to provide the correct support for liberal activities depends on its ability to recognize a bias in its own preferences. The disagreement between Jefferson and Adams concerns which group was most likely to make the correct political choices. Jefferson did not claim that virtue and wisdom coincide with the views of the majority, or Adams that they coincide with the views of the rich. Their disagreement concerned whether the majority or the rich were more likely to respect virtue and knowledge that they did not fully share.

Rather than trying to resolve this disagreement, we will consider some insights that our analysis offers into the institutional mechanisms by which cultural activities can best be supported. The majority, when it supports cultural activities, has two alternatives: to make voluntary contributions, or to enact public subsidies. Our analysis should make us aware of some perils of the latter alternative. Recall that the argument for state subsidies of cultural
activities rested upon a personal commitment by citizens to excellence. A modern democracy provides many private means of personal commitment to excellence besides the state. Using state power to enforce such a commitment coerces minorities in a pluralistic democracy, whereas the private means are not coercive. The citizens of a pluralistic democracy should regard skeptically anyone who wants to enlist state power to extract support for cultural activities, not because all activities are equally worthwhile but because the state should maintain substantial neutrality toward alternative visions of worthwhile activities.

This skepticism should assume a characteristic form inspired by the economic framework for justifying public policy. Proponents of collective commitment should have the burden of proving a "market failure" that obstructs personal commitment. For example, such a demonstration might begin by proving the existence of increasing returns to the scale of commitment. Or the demonstration might proceed by proving that a certain class of merit goods also have the character of public goods.

It seems likely that many of the public subsidies for the arts cannot be defended on grounds of increasing returns to scale or the public character of merit goods. For example, poetry reading and symphonic music probably lack these characteristics. Consequently, there must be a presumption that these merit goods should be subsidized largely from private donations, in order to avoid coercion and corruption of purpose that plagues collective action.

After demonstrating a market failure, the next step in justifying collective action is to demonstrate that the incentive structure of the institutional form for implementing collective choice will serve excellence rather than merely transferring income to politically favored groups. In a democracy, the beneficiaries of public subsidies inevitably organize themselves as interest groups to maximize transfer payments. This is true of all three classes (rich, majority, aristoi), as evidenced by industrial subsidies, social security payments, or cultural subsidies. Collective provision of merit goods must be organized to avoid an incentive structure that rewards wasteful expenditures by the beneficiaries to increase their level of subsidy.

We have argued in favor of individual donations over taxes as a means of supporting cultural activities. Individual donors can support cultural activities in two distinctly different ways. One possibility is to contribute to current expenditures on particular activities. Another possibility is to create passive endowments for institutions such as universities and foundations. Our analysis shows that there is one great advantage to the latter alternative. Unlike hereditary elites, passively endowed organizations can have an internal structure
designed to promote excellence over many generations. Consequently, the foundation for excellence in a democracy should be the endowment of private institutions dedicated to cultural activities.

**Conclusion**

The modern case for economic equality rests upon the belief that equal is fair. Opposed to it is the belief that exchange should be free and free exchange is efficient. Thus the modern debate about redistribution turns upon the ideals of equality, liberty, and efficiency. The ancient debate, however, focused more on cultural values. The best should have more, according to the ancient argument, for the sake of cultural excellence. We have tried to rethink the cultural argument for unearned income in order to situate it in a democratic society.

Cultural excellence exerts a continuing influence in a democracy, as evidenced by some current data on cultural subsidies in the United States. In 1987, 8% of American households contributed to charities in the category “arts, culture, and humanities,” and 15% contributed to educational charities. Furthermore, the endowment of institutions of higher education in the United States exceeded $50 billion in 1985–86. Turning to the public sector, the National Foundation of Arts and Humanities had appropriations of $140 million in 1988. The National Science Foundation had appropriations for research and related activities of $1,453 million in the same year.

The justification and critique of these expenditures must rely upon the cultural defense of unearned income. This defense requires a framework which recognizes that some activities are more worthwhile than others and acknowledges that organized interests drive democratic politics. We have tried to expand economic theory to provide such a framework by combining Aristotle’s concept of akrasia with collective choice theory.

Our model of akrasia suggests how cultural excellence should be furthered in a democracy. First, personal commitment should be preferred to collective commitment. Personal commitment might take the form of donations and voluntary support for cultural organizations, as opposed to public subsidies from taxes. Unlike hereditary elites, passively endowed organizations can arrange their internal structure to promote excellence, and their success in doing so

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24. Ibid., table 292, p. 315.
will determine the extent to which they flourish in the competition for voluntary contributions.

Second, collective provision might be required in some circumstances. Proponents of collective provision of merit goods should have the burden of proving a "market failure," which obstructs personal commitment or gives a public character to the merit goods in question. Having demonstrated a market failure, proponents should go to the next step of demonstrating that the incentive structure for implementing collective choice will serve excellence rather than transferring income to politically favored groups.

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