

'Rationality, Individualism and Public Policy'

in the Light of Pareto

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I Introduction

The proceedings of the 1986 conference on consumer sovereignty and public policy at the Australian National University were edited by Geoffrey Brennan and Cliff Walsh, and published in 1990 under the title *Rationality, Individualism and Public Policy*. By and large, the published proceedings consider the normative implications of consumer sovereignty when:

- the benefit from some goods are 'socially irreducible' and cannot be analysed by focusing on the individual;
- human behaviour is (apparently) irrational;
- preferences are manipulated through the provision of 'merit' goods; and
- preferences are differentiated by type (eg. revealed or true preferences) and by institution in which they are expressed (eg. the market or the ballot box).

The book includes widely varied papers. The conference organisers invited participants from a variety of academic backgrounds, primarily in economics but also in politics and philosophy. This is an implicit recognition of the need for a multi-discipline approach to public policy once the logical nature of individuals' behaviour is called into question. An unfortunate consequence of the multi-discipline base of the conference is the very narrow agreed analytical base from which a policy framework could be developed. This paper contends that a multi-discipline framework designed to facilitate examination of many of the above issues was developed eighty years ago by Vilfredo Pareto. Moreover, the framework is still a relevant starting point for an examination of issues such as those addressed at the conference.

While Pareto's two volume 1896 and 1897 *Cours d'économie politique* (Pareto 1949a and 1949b), and his 1906 *Manuale d'economia politica* (Pareto 1971) lay the foundations for the study of 'logical' and 'non-logical' actions, it is his 1916 work, *Trattato di Sociologia Generale* (Pareto 1935) that provides indispensable insights into the relationship between 'nonlogical' actions and 'utility' - the very relationship which, economists generally contend, must be clearly established before policy that overrides consumer sovereignty is considered. Despite this, there is no mention in the conference papers of Pareto's pioneering work on non-logical actions. In fact, it is ironic that the only reference to Pareto concerns rational actions of economic agents (ie. achieving Pareto optimality when rational consumers are sovereign).

The objective of this paper is to clarify and analyse the main issues raised in *Rationality, Individualism, and Public Policy* using Pareto's framework for the study of logical and non-logical actions. Section II of this paper briefly sketches Pareto's theory of social equilibrium. Section III examines the critique of methodological individualism - on the grounds that some goods are socially irreducible - and demonstrates that the critique does not apply to Pareto's system of mutual social and economic interdependence. Section IV examines rational and irrational actions in the context of the public choice distinction between 'in-period' behaviour and 'constitutional period' behaviour, as well as irrationality as one basis for merit good provision. Section V examines utility interdependence and the merit good argument in terms of preference correction of non-logical (but still rational) actions. Section

VI evaluates the implications for theory and policy when individuals reveal multiple and inconsistent preferences in different institutions. Some conclusions are given in section VII.

II Fundamental Elements of Pareto's Theory of Social Equilibrium

At least two fundamental constants survive the transition between the *Cours* and the *Trattato*. One is Pareto's conclusion that economic theory examines logical actions in terms of 'ophelimity', while most social phenomena are analysed in relation to the broader and vaguer concept of utility. The second is his contention that general social phenomena as well as economic phenomena can be analysed using a system of interdependent elements.

Ophelimity¹ is categorised in the *Cours* as a sub-class of utility, and is '...simply a pleasant sensation...' (Pareto 1949b, p. 442) which is unrelated to ethical considerations. While Pareto indicates that there are different species of ophelimity, such as religious or moral ophelimity, he generally reserved the term for use in the context of economic phenomena. In the *Manuale*, ophelimity is more precisely specified as tastes or "pleasure which man experiences when he consumes certain things, or when he uses them." (Pareto 1971, p. 181).

Utility is defined much more broadly as a subjective assessment of material, physical, intellectual and moral well-being, and the reproduction of these states of well being over time (Pareto 1949b, p. 441). Human sentiments, including feelings and beliefs, are the source of the 'subjective assessment' associated with well being. Consequently, utility is essentially a feeling of satisfaction derived from sentiment, which has an economic element (ie. material well-being) and a non-economic element (ie. physical, intellectual and moral well-being). Tarascio suggests that: "...Pareto made the distinction between ophelimity and utility, so that confusion between strictly economic and social (both economic and non-economic) considerations would be avoided." (Tarascio 1969, p. 7).

Throughout his academic life Pareto remained convinced of the explanatory power of Walras' analysis of mutual dependence between economic phenomena in the determination of equilibrium. In correspondence to Maffeo Pantaleoni on 10 February 1897, he noted that: "Walras' merit, to my mind, is ... in having been the first to postulate the general equations of economic equilibrium. It is because Walras had worked out these general equations that I was able to understand and explain the economic phenomenon..." (Pareto in Schneider 1961, p. 258). The theoretical constructs developed in the *Cours*, and to an even greater extent in the *Manuale*, focus primarily on general economic equilibrium using the very abstract creation, *homo oeconomicus*². That is, man stripped "... of a large number of accretions, ignoring his passions, whether good or bad, and reducing him to a sort of molecule that only acts in response to the forces of ophelimity." (Pareto in Finer 1966, p. 98).

Pareto raises the issue of "the mutual dependence of social phenomena" in the second volume of the *Cours*. In the *Manuale*, he goes so far as to suggest that other theories were required to complement the study of *homo oeconomicus*, such as the study of *homo ethicus* and *homo religiosus* (Pareto 1971, p. 13). However, he never formally developed models based on these specific abstractions. Instead, he explored the nature of the interdependence between social phenomena in his *Trattato* using a related but new series of concepts derived from observable behaviour which is ultimately sourced to the human psyche. The most well known are *residues* and *derivations*.

Residues are the manifestations of human sentiments and instincts (Pareto 1935, p. 509). They represent a diverse range of actions related to individuals' psychic states (Pareto 1935, p. 514). Examples of sentiments that Pareto refers to include 'faith', and belief, all of which may be characterised as elements of the human conscience. Since Pareto judged that knowledge of human psychology was limited, his residue is the manifestation or the

observable action associated with sentiment, rather than sentiment itself. Specific examples of sentiments manifest as residues include self sacrifice, social hierarchy, vengeance, pity etc.

Pareto considers six classes of residues, though his analysis of social equilibrium focuses on the two most important classes. Class 1 residues are associated with the instinct for combination. This includes the human tendency to associate things (eg. like with like), as well as the association of ideals and things (eg. 'good things' create happiness). Class 2 residues are actions associated with the preservation of existing social aggregates. The first of these residues leads to innovations within society because it is concerned with an individual's "propensity to take disparate elements out of their familiar context and unite them together in new combinations." (Finer 1966, p. 39). Conversely, the second class of residue is concerned with preserving an existing social aggregate such as patriotism.

Derivations, as the name suggests, derive from residues (Pareto 1935, pp. 885 - 886). They are largely pseudo-logical rationalisations of ethical, religious and moral notions using logic as well as sentiment, and are manifest in words. Derivations may deal with social phenomena in the simplest way and be clearly interpreted by all as subjective value judgments. A simple assertion like "justice demands that criminals are jailed" is an example of a derivation. At the other extreme, derivations may be presented as scientific theories with unstated or disguised links to sentiment. For example, the use of economic theory to suggest that *laissez faire* is welfare maximising. The derivation is important because it "expresses clearly ideas that people have in a confused sort of way...[and] lends strength and aggressiveness to the corresponding sentiments." (Pareto 1935, p. 1202). Finer (1966, p. 44) concludes that derivations are important for the reason that they make residues more or less intense.

Residues are essentially a constant influence on behaviour in that they reflect the human psyche. Derivations, on the other hand, are creations of the human psyche. They are produced on an ongoing basis by different individuals and groups. Consequently, each derivation rationalises a slightly different combination of sentiments as a correct, actual, equitable, efficient etc. basis for human actions. They are, therefore, a variable influence on human behaviour.

Actions influenced by residues and derivations are analysed by Pareto in terms of the utility they generate for individuals and the implications for the community as a whole. Since derivations act directly on individuals' utility and consequently on their preferences for social outcomes (ie. the actions of other individuals), Pareto found the methodology of economics which assumes that sentiment is an invariable influence on preferences was not suited to a complete social study.

"In the economic system the non-logical element is relegated entirely to tastes and disregarded... One might wonder, whether ...we might not relegate the non-logical element to the residues ... and proceed to examine the logical conduct that originates in the residues. That, indeed, would yield a science similar to pure, or even to applied, economics. But unfortunately the similarity ceases when we come to the question of correspondences with reality... In activity based on residues human beings use derivations more frequently than strict logical reasonings... Residues are not, like tastes, merely sources of conduct; they function throughout the whole course of the conduct developing from the source, a fact which becomes apparent in the substitution of derivations for logical reasonings." (Pareto 1935, pp. 1442 - 1443).

In the light of this Pareto classes *opheimity* maximising economic behaviour as logical because reasoning about the means-ends relationships is logically derived from the

given initial premise, and without resort to sentiment. In contrast, utility maximising social behaviour is not only subjectively inspired, the means of the means-end relationship are also generally influenced by sentimental considerations. Consequently, utility maximisation concerns non-logical actions. This does not suggest that governments should exclude ethical and moral considerations from the policy development process, only that the process involves non-logical (but not irrational) considerations like ethics. In fact, Pareto concluded that, for most people, nonlogical actions are more numerous than logical actions (Pareto in Finer 1966, p. 20), and that policy should account for economic and social considerations.

There is some suggestion, notably by Talcott Parsons, that Pareto's theory of residues and derivations actually constitutes abstract societies or social systems, but that Pareto "did not carry the explicit treatment of non-logical action beyond the isolated unit act to consider the structure of total systems of action" (Parsons 1968, p. 268). This implies that Pareto's sociology does not fully integrate analysis using methodological individualism because there is no step linking the unit act with system outcomes. However, Pareto's analysis of social equilibrium is not confined to his theories of residues and derivations. Social heterogeneity and interests also play a major role and these are readily related to individuals.

Social heterogeneity concerns the relationship between individuals and the social structure. It is based on the fact "that individuals are physically, morally and intellectually different" (Pareto 1935, p. 2025). Pareto contended that individuals tend to associate in groups or classes, and that within each class there is a process of imperfect social selection to identify individuals who are the best at pursuing class interests, i.e. *elites*. Pareto characterised individuals' association with groups as a dynamic process where, subject to selection via socially determined processes, individuals may move into and out of elites, within and between classes. Elites themselves don't endure, they are replaced by other elites once they can no longer sustain a strong conviction in their beliefs because they have lost the energy and drive to do what must be done to retain authority. For example, governments are portrayed as elites, and the change of government, or even a change in the system of government, constitutes Pareto's 'circulation of elites'.

Interests, or more specifically economic interests, are associated with the desire to acquire material goods (Pareto 1935, p. 1406). Finer interprets Pareto's 'interests' as the means to achieve any personal ends, of which "...wealth and power and consideration are the most important..." (Finer 1966, p. 49).

Pareto's social equilibrium occurs when each of the above four abstract social 'molecules' (i.e. *residues, derivations, social heterogeneity and circulation of elites, and interests*) interact with each other (Pareto 1935, pp. 1541 - 1542). Since the equilibrium points for each of the four elements are not the same, the system wide equilibrium moves and fluctuates through time, as Luigi Amoroso notes: "...the single actions and reactions are compounded and interfere in a thousand ways and from their contrast arises the social movement. Analysing the single interferences, Pareto deduces the oscillatory character of this movement. The single oscillations constitute the *economic and social cycles* and form the warp on which are interwoven the vicissitudes of the history of human society." (Amoroso 1938, p. 13).

III Atomism

Taylor's Attack on Methodological Individualism

In the paper titled *Irreducibly Social Goods*, Taylor (1990) attacks welfare economics, or welfarism, and rejects 'methodological individualism' on the grounds that treatment of the collectivity as if it were atomistic is not a valid premise. His related objective is to criticise 'subjectivism' in economics when it finds expression through the concept of 'utility'.

Taylor's primary hypothesis is that benefits from all goods can not be decomposed to the benefits enjoyed by individuals, even after public goods have been accounted for. In support of this view, he notes that some goods exert a significant influence on the perceptions of the members of a collective. Language itself is portrayed as the foundation on which his notion of socially irreducible goods is developed. This is because factors such as roles, customs, rules and laws are assessed through thoughts specific to a given linguistic background that reflect concepts of social and cultural significance. "...a language is created and sustained in the continuing interchanges that take place in a certain linguistic community. This linguistic community is its locus; and that is what ultimately rules out methodological individualism." (Taylor 1990, pp.51-52).

Taylor suggests that 'plain events' do not require a linguistic background to determine their meaning, but 'meaning events' do because they reflect society's culture which is inextricably linked to language. He asserts that atomism is not only deficient in the study of 'meaning events', but also 'plain events' because these have to be justified against a background of understanding about how society works. To illustrate these concepts, consider an individual's decision to purchase a copy of the Koran. The purchase of goods is a 'plain event', but this purchase is best understood in the context of meaning events (ie. the cultural or legal dominance of Islam in the community of which the individual is a member).

Welfarism endorses atomism and accepts individuals' judgments without differentiating between plain and meaning events. From this Taylor deduces that the value of meaning events are diminished in welfarism. Furthermore, welfarism has no role for 'moral arguments' that are at odds with individuals' assessment of utility, thereby providing the basis for a pro-altruistic philanthropy.

Reducing the Irreducible

Interdependent atomism which utilises Pareto's distinction between ophelimity and utility does not suffer from the shortcomings that Taylor suggests apply to methodological individualism and welfarism. One of the elements of Pareto's equilibrium is social heterogeneity, which is presented in terms of classes and elites. However, this does not constitute a repudiation of atomism, it is simply an analytical approximation. In the discussion of 'social physiology' in the *Cours*, Pareto notes that:

"...social phenomena are the result of all the forces that operate in society, from all the qualities and defects of all its citizens. Contributions of various characteristics constitute SOCIAL CLASSES. It is sometimes the family; the real or supposed origin of a community; religious practices; the same type of occupation; etc. But one of the principle causes of differentiation among the social classes is certainly wealth. The rich have a tendency to group themselves, the same as the middle class and the poor." (Pareto 1949b, p. 428).

Class relationships within social systems are verifiable by observation, whereas the interdependencies between individuals which shape these relationships are much more difficult to discern. They are numerous and occur over generations. However, this does not mean that benefits are socially irreducible, because social groupings are a manifestation of human sentiment. Preservation of social aggregates and associated values can be confirmed in all societies. It is an attribute of the human psyche, and not the consequence of a particular form of society, so ultimately all benefits and costs associated with uniformities that extend over many social forms are reducible. Similarly, development of knowledge and the modification of beliefs is not limited to societies of any particular social form or structure. Individuals exhibit residues associated with preservation and innovation in varying

proportions, and change in dominant cultural values depend on the interaction between these (and other) factors.

Taylor's case for classing certain goods, like language and culture, as purely social and irreducible does not fully acknowledge interaction effects between heterogeneous individuals on social utility. Essentially, it is the valuation of cultural and ethical values as if they were simply pleasure generating tastes which does not stand up to Taylor's critique of atomistic welfare economics, not atomism *per se*.

Consider the case of language, which is presented by Taylor as an extremely important socially irreducible good. Pareto classed language as an organism developed in conformity to its own laws by non-logical processes (Pareto 1935, pp. 513-514). Generally it is developed by the population at large in response to spontaneous forces (Pareto 1935, p. 1128). A vast number of words within a language "arouse indefinite sentiments but otherwise correspond to nothing real. There is nothing objective corresponding to the terms... 'good' and 'bad,' 'beautiful' and 'ugly,' 'honest' and 'dishonest,' 'just' and 'unjust,' 'moral' and 'immoral'..." (Pareto 1935, p.994). However, these vague words, and language development in a particular country, are related with the development of community values.

"All individuals who speak a given language express almost identical sentiments in terms on the whole similar. In the same way individuals who live in a given environment and are affected by its many influences are inclined to manifest almost identical sentiments in very similar forms. The similarity extends to the derivations, or manifestations of different residues." (Pareto 1935, p.1404).

The important point is the fact that linguistic and cultural concepts evolved. This is a general uniformity that cuts across all societies. The common element is interaction between the members of society, and just like social evolution, linguistic and cultural concepts will both continue to evolve as a result of interaction between people.

At a very broad level, events related to Pareto's study of ophelimity and economic interests could be considered the atomistic equivalent to Taylor's 'plain events' because ophelimity concerns desires independent of cultural constraints. Similarly, phenomena related to utility, such as residues, derivations and social heterogeneity, may be viewed as the socially reducible equivalent to Taylor's 'meaning events'. Taylor's attempt to classify meaning events as socially irreducible appears to reflect a preference for conservation of culture, and as such is a derivation which places great weight on Pareto's second residue - ie. the preservation of existing social aggregates.

IV Rational and Irrational Behaviour

Rational Behaviour

In his *The Normative Status of Consumer Sovereignty*, Hamlin (1990) utilises methodological individualism to demonstrate that apparently irrational actions may in fact be rational and in conformity with consumer sovereignty. To do this he differentiates between decision making at the 'critical' (or 'constitutional') level and the 'in-period' (or 'practical') level. In brief, critical level decisions relate to actions which influence rule making, and in-period level actions are of a non-rule making kind, but which have been made in light of constitutional actions. Constitutional actions may be undertaken privately (eg. a contractual arrangement governing future actions) and publicly.

The conventional specification of consumer sovereignty concerns social outcomes "valued by reference to preferences, but this valuation is independent of the process which

brings the outcome into existence" (Hamlin 1990, p. 3). That is, it is considered at the 'in-period' level. Consumer sovereignty considered at the 'critical' level concerns the establishment of rules which set the parameters of human behaviour that accord with individuals' underlying preferences. For example, an agreement or law to prohibit specific actions because they may modify individuals' preferences.

Consumer sovereignty at the critical level recognises that market failure can be internal to the individual. The problems of internal market failure are analogous to external market failures, implying that market failure is due to both externalities and internalities. In both instances actions at the constitutional stage may be designed to correct these failures.

The fundamental problem with 'in-period' and 'critical' level preferences is that the distinction is arbitrary, and based on a biased perception of rules and the rule making process. People choose to ignore or accept rules depending on their assessment of the role of rules and laws generally, the merit of the particular rule in question, and the obstacles which prevent rules being violated, such as sanctions. A rule is generally accepted or rejected by an individual after it has been developed and/or evaluated with respect to tastes and sentiments. Each time that a non rule making act is undertaken, it is an act of confirmation or rejection of that rule. Consequently most in-period behaviour also has a rule making element.

To the extent that a society is dominated by residues associated with preservation of existing social arrangements, established rules will tend to be respected. The converse will apply when society is dominated by residues associated with reorganising society through innovation. Since social equilibrium oscillates, the ratio of conservative to innovative individuals in society may not remain constant over time, and the life expectancy of a rule will ultimately depend on interaction between the elements of social and economic equilibrium.

Hamlin's contention that consumer sovereignty is appropriately considered at the critical level relies on conservative sentiment (ie. acceptance of laws, or more specifically constitutionally determined rules of behaviour). The importance of sentiment in Hamlin's defence of consumer sovereignty is clearly evident even from his examination of some of the traditional critiques of consumer sovereignty, particularly those related to endogeneity of preferences and undesirable preferences.

Hamlin identifies two distinct types of endogenous preferences: i) intended preference manipulation as a direct result of other peoples behaviour; and ii) unintended preference changes that result from social interaction. For individuals themselves, intended preference manipulation may even be intended to constrain one's own behaviour.

"At the critical level I may wish to reform my preferences and so choose social arrangements which will force me to act in ways that bring about the desired preference change. This may be more effective...than any available strategy of character planning which operates totally internally and in the face of my present preferences." (Hamlin 1990, p. 8).

However, it is not necessary to view voluntarily private arrangements that specify particular short and long term preference trade offs as a critical versus in-period issue. This is just an example of consumers assessing the intertemporal costs and benefits of their choices. This issue is more contentious when an individual attempts to manipulate others' preferences, either privately or through public policy. Hamlin believes that such intended manipulation is analogous to the use of coercive physical force to achieve an outcome.

"I would suggest that our intuitive rejection of the individual's 'right to manipulate' is founded on the same grounds as our rejection of the 'right to coerce'. This suggests that in-period consumer sovereignty must be restricted in

such a way as to rule out such acts of intentional manipulation in the same way that it may be restricted to rule out acts of coercion." (Hamlin 1990, pp. 7-8).

However, contrary to Hamlin's suggestion, coercion is a recognised right in most societies in given circumstances. Police may threaten or apply physically coercive techniques to prevent criminal acts or arrest individuals. Negative sanctions against anti-social behaviour such as corporal punishment are also coercive, as are many instances of military discipline. Similarly, there are many instances when intended preference manipulation is regarded as legitimate by the community at large eg. criminal rehabilitation programs. Governments generally set the parameters which determine the circumstances when coercion is regarded as unacceptable, and the type and level of coercive force that is regarded as warranted.

Hamlin is simply expressing a belief that coercion and intended manipulation of other peoples preferences are absolute bads, contrary to the practice in most societies where coercion is regarded as a relative bad, but which can be tolerated if it generates perceived public benefits such as greater compliance with the law.

The overt dependence on sentiment in Hamlin's analysis is evident when he makes the analysis conditional on "...the laundering of preferences if they conflict with the underlying values of individualism" (Hamlin 1990, p. 14). The fact is that some members of society have little or no regard for others. By mixing analysis with laundered preferences, Hamlin has written what Pareto would term a *derivation*, and the 'analytical' divisions between critical and in-period levels have more to do with rationalisation of a particular approach to policy, than the positive foundations of policy.

Irrational Behaviour

A major goal of *Rationality, Individualism and Public Policy* was to consider the development of the merit good concept since it was initially proposed by Richard Musgrave in the late 1950's. Since the initial rationale for over-riding individual preferences by providing merit goods was the impact of imperfect information and irrationality (Head 1990, pp. 224-225), it is appropriate to consider some of the less contentious aspects of merit goods in this section.³

Merit goods are rationalised on the basis that when people are irrational or information is imperfect, consumer sovereignty may not be an appropriate goal. In such circumstances, merit goods provision would be sub-optimal for a given set of preferences, but may alter (or correct) preferences and improve welfare. Brennan (1990) and Walsh (1990) primarily discuss the rationale for merit goods in terms of individual irrationality when revealed preferences are not an indication of a person's true preferences, or when they don't act to maximise benefits in accordance with their preferences.

One hundred years ago in the *Cours*, Pareto addressed the same issue, but in the context of children and intellectually handicapped people. Basically he suggested that there may be a case for overriding preferences when individuals' tastes are contrary to their well being, or when the direct sacrifice to individuals' well-being from overriding their preferences is more than offset by the indirect benefits that the same individual will receive from the general social changes that this action has brought about.

"When the use of coercive force is not limited exclusively to the advantage of the person or persons deploying it, their exercise in securing advantage is called tutelage. It may be to the direct advantage of the dependent person, or to his indirect advantage if the exercise of tutelage is of direct advantage to the social aggregate of which he is a part. The first type can be termed private tutelage, the second public tutelage. Private tutelage originates from the

difference between ophelimity and direct utility for the dependent; public tutelage mainly originates from the difference between direct utility for the individual and his indirect utility consequent upon direct utility for the aggregate. In cases where tutelage brings no utility, direct or indirect, for the individual, it should not be confused with tutelage in the proper sense." (Pareto in Finer 1966, p. 108).

However, as Pareto warns, tutelage can result in grave abuses such as child exploitation by parents and greed as a motive for committing people to asylums (Pareto in Finer 1966, p. 109). Similarly, justifying the public provision of certain services as merit goods that correct irrational preferences, and/or imperfect information, may be subject to abuse. It may also be simply misguided and lead to, what Walsh calls, the "slippery slope of paternalism" (Walsh 1990, p. 149).

V Preference Manipulation and Non-logical Actions

Non-logical Preferences

In order to examine preference 'correction' and merit goods, Head (1990, pp. 219 - 220) reformed welfare economics by utilising the Pigovian distinction between individuals' (ex-ante) desires and (ex-post) satisfactions, and added an additional series of preferences based on ethics and morals. Three alternative interpretations of social welfare are then derived:

- welfare as a function of standard (ex-ante) utility indicators of revealed preferences ie. I-preferences
- welfare as a function of (ex-post) indicators of preferences based on tastes ie. P-preferences
- welfare as a function of ethics or welfare-relevant preferences which are the ultimate or highest order preferences i.e. W-preferences.

W preferences are deemed higher order preferences than P and I preferences, and P preferences are deemed to be of a high order than I preferences.

Since the actions of Pareto's *homo oeconomicus* in general equilibrium only relate to the "many logical and repeat actions...to procure the things which satisfy tastes" (Pareto 1971, p. 107), P preferences are essentially the same as Pareto's indices of ophelimity. W preferences are equivalent to preferences under Pareto's definition of utility (though in Pareto's analytical system there would be no place for preference ordering of the following type: 'higher order', 'lower order' or 'ethically relevant' preferences).

This distinction between I and P preferences can be used to account for weakness of will and addiction issues (Head 1990, p. 223). It is relatively uncontroversial to correct I preferences to represent P preferences, and this does not violate consumer sovereignty. It is simply a recognition that people often do not have sufficient information for I and P preferences to be the same. It is more controversial when P preferences conflict with W preferences, such that "lower order market preferences may require correction in light of higher order moral values" (Head 1990, p. 226). For example, P preferences for prostitution, abortion or discrimination may, if acted on, maximise 'ophelimity' but diminish 'utility' based on W preferences.

The 'non-logical' case for merit goods is related to W preferences overriding lower order preferences, and also 'utility interdependence' and preference endogeneity. As Walsh notes, a "...feature of merit good policies that is sometimes raised is the fact that their implementation cannot be associated with 'potential Pareto improvements' as that term is usually understood." (Walsh 1990, p. 168). Although Walsh's reference to the usual

understanding of Pareto Optimality is in reference to welfare improvements after corrections for externalities, this also begs the question - does the usual understanding accord with Pareto's work in this area?

Pareto's Economic and Sociological Optimalities

Cirillo (1979, p. 58) has suggested that Pareto may have developed his ophelimity maximising criteria to define the limits of economics as a science. If this is so, it is a limit that welfare and policy economists have chosen to disregard by developing the concept well beyond matters of 'tastes' and incorporating ethics and morals.

Pareto posed two sets of welfare criteria for social groups, one for economics and one set for sociology. The welfare criterion for economics is called 'the maximum of ophelimity for a community' by Pareto. Sociology has two criteria, 'the maximum of utility for a community', and 'the maximum of utility of a community'.

Maximum of ophelimity for a community focuses on changes up to the point that it is not possible to procure greater benefits for all individuals "without resort to other considerations foreign to economics - to decide on the grounds of ethics, social utility or something else" (Pareto 1935, p. 1467). Since ethics are explicitly excluded, it is not legitimate to criticise this criteria on the grounds that it does not measure benefits or costs from employing public policy to alter the distribution of income. This is beyond the scope of ophelimity and Pareto's economics. To address this issue, one must turn to Pareto's maximising criteria in sociology, though they are somewhat more controversial.

The maximum of utility for a community in sociology concerns the maximum of individual's utility without anyone being worse off. This explicitly recognises utility interdependence (ie. where individual's utility is sensitive to the well being of others). The second sociological criterion, 'the maximum of utility of a community', abandons the requirement that every one's utility improves as a result of an action. Instead it reflects the principle that the community as an entity is better off, with some individuals gaining and others losing.⁴

The fundamental difference between economic and sociological optimalities in Pareto's analysis is that only the former is totally individualistic. The latter concerns the collective and requires a means of combining individuals' heterogeneous utilities into a single homogeneous form. However, this can not be achieved objectively (or at least not unless very restrictive conditions are assumed). Pareto's solution to this problem is to incorporate the Government's subjective estimates of social utility to develop what Tarascio (1993, p. 52) calls the 'political welfare function'.

The first step in considering sociological optimalities involves each individual weighting preferences for their consumption of a particular good or service, as well as for other individuals' consumption of that good or service. In his 1913 *Il Massimo di utilita per un collectivita in sociologia* (1992) Pareto represents this particular commodity interdependence (ie. redistribution in kind) as a matrix welfare equation. The weighting of preferences is undertaken by each individual assigning coefficients of consumption for all members of society. When the commodity in question is the distribution of income, the matrix deals with general utility interdependence (ie. redistribution in cash). In such circumstances:

"The admirer of the "superman" will assign a coefficient of approximately zero to the utility of the lower classes, and get a point of equilibrium very close to the point where large inequalities prevail. The lover of equality will assign a high coefficient to the utility of the lower classes and get a point of equilibrium very close to the egalitarian condition. There is no criterion save sentiment for choosing between the one and the other." (Pareto 1935, p. 1472).

The second step adds an additional series of coefficients to weight each individual's contribution to social welfare. This is to facilitate the aggregation of individual preferences to determine social utility. However, these coefficients do not reflect objective weights because one can not make objective interpersonal comparisons of utility. They reflect a sentiment which endorses "... politically determined averages of corresponding coefficients that individuals themselves might deem appropriate." (Bergson 1983, p. 43). Having specified the political welfare function, policy can be pursued to either maximise utility *for*, or *of*, the community.

Modern welfare economics is consistent with Pareto's analysis of ophelimity maximisation, and the first step employed by Pareto when considering his sociological optimalities. The second step, involving interpersonal comparison via the political process, is notable by its absence. In *Rationality, Individualism and Public Policy*, utility interdependence is discussed as a possible basis for merit good provision. However, the pioneering research by Hochman and Rogers (1969) and Olson (1969) demonstrated that explicit recognition of utility interdependence may require in-cash and/or in-kind redistribution that is Pareto optimal in the conventional sense (ie. accepting Pareto's first step for the consideration of sociological optimalities, but without resort to interpersonal comparison of utilities). In the light of this, most authors accepted that in-kind redistribution can be rationalised in terms of Pareto optimality without necessarily being justified in terms of preference manipulation, so it was not considered a prime reason for merit good provision. As a consequence, the meaning of merit goods is vague when considered in the context of non-logical actions.

"...individual choice is more complex than assumed in the conventional model; because individuals recognise social constraints on their own preferences; because giving takes paternalistic form; or because concepts of distributive justice relate to the availability of particular goods rather than to income or wealth at large. These situations share a departure from the conventional premise of consumer choice, but beyond this they are too divergent to yield a unique definition of the merit good term" (Musgrave 1990, p. 210).

However, by adopting Pareto's political welfare function, there is a positive basis for considering political actions to manipulate individuals' preferences. When an individual's utility maximising behaviour differs from what the Government judges to be best for the community, there are two coercive means by which the Government can attempt to alter the individuals actions, namely force and consent. This is evident from the following comments by Tarascio which relate to an example devised by Pareto (1935, p. 1473):

"The individual may be forced to move [from *q*] to *t*, with the direct consequence that his utility declines. It may be the case that he later experiences an indirect gain in utility at *t*...This case implies a transformation in the individual's subjective welfare function. Or the Government may wish to induce the individual to move from *q* to *t* voluntarily. This is where "derivations" enter the scene in Paretian utility theory...In order to induce the individual to make the movement, it may be necessary to offer a promise of a gain, or even a fantastic gain, in utility. In short, the function of the derivation is to blend the individual's social preferences with those deriving from social utility." (Tarascio 1993, p. 53).

Head (1990, pp. 233-236) suggests that the main rational justifications for merit goods are utility interdependence and endogenous preferences manifest as 'community values'. However, just as the political welfare function enables utility interdependence to be considered, so too does Pareto's framework allow for the evolution of 'community values' to be considered, and indeed integrated with the study of social equilibrium. Nevertheless, they are sociological considerations, in that they relate to utility from rational but non-logical social interactions inspired by residues and derivations, and are beyond the scope of Pareto's economics.

VI Preference Differentiation by Type and Institution

A different approach is taken by Brennan (1990) in his *Irrational Action, Individual Sovereignty and The Political Process* to the issues of ethics, values and merit goods. He argues that a case can be made for publicly provided merit goods when the cost of supplying merit goods exceeds the cost which voters' estimate that they will contribute as a *direct* result of their voting decisions. Using the public choice convention, Brennan suggests that "the institutional context in which preferences are revealed makes a difference to what is revealed" (1990, p. 104). In both the market and the political process, choice involves an 'instrumental return' derived from achieving a desired outcome, and an 'intrinsic return' derived from 'expressing a preference'. (Brennan 1990, pp. 106 - 107). However, the cost to the individual of expressing preferences in the market is greater than in the political process.

By deduction, Brennan suggests that an individual will only reveal the same preferences in the market and the political process when the probability that an individual's vote will be decisive (ie. determine the outcome of an election because all other votes are tied) is equal to one. If one accepts the hypothesis that expression of values is responsive to relative price, then "values are more likely to be expressed accurately when the cost of doing so is low." (Brennan 1990, p. 114).

Since the probability of an individual's vote being decisive is extremely low, preferences revealed through the act of voting will have little effect on the cost of public policy met by the voter. From this Brennan deduces that individuals will be more likely to reflect their values in the voting process than in preferences revealed in the market. If one also accepts that values require a reflective environment, and market activity is not conducive to moral conduct, "it may be that expressive preferences revealed in voting are a truer reflection of the agent's values than the 'interests' that the agent reveals in action" (Brennan 1990, p.116), thereby justifying merit good choices being made through the political process.

The obvious difficulty with Brennan's model is that the agent's values are not revealed, so it is not possible to determine whether some revealed preferences are a truer reflection of values than others. It is an entirely subjective exercise to determine whether market or voter preferences are closer to individual's values, or even what true preferences are and how they can be derived from preference revelation which varies between institutional settings.

Moreover, the meaning of 'preferences' revealed at the polling booth is unclear. Apart from the fact that ballots are usually secret (Pincus 1990, p. 134), political candidates have campaign platforms covering a full range of public programs, strategic alliances and often hidden agendas. Derivations abound at election time. Voters select a candidate by placing a series of numbers next to a series of names, or by other similar methods, after interpreting the derivations, (discounting some and accentuating others in non-systematic ways), and taking other non-policy related factors into consideration. What this actually reveals about utility is uncertain.

Pareto regarded the form of government and the means of its selection as a secondary issue relative to the general uniformities evident in various forms of Government. Using Brennan's term, Pareto's focus was on the instrument return from the political process. He did so by emphasising the balance of *consent* and *force* employed in political systems, including democracies, to realise these returns. Focusing on intrinsic (and instrument) returns without considering the balance of force and consent in political systems, is analogous to examining an economic market without regard for the regulation of that market by Government.

In contrast to Brennan, Hamlin (1990) suggests that individuals actually incorporate several preferences at one time, with each set of preferences reflecting a particular concept. Consequently, for *homo oeconomicus* choice is decisive and the full cost of the choice is met by the choice maker. Preferences revealed by *homo sympatheticus* are conversely not decisive and the cost of expressing these preferences in a political forum is slight. This "endogenous switching of an issue from one context to another (from the market to the forum and vice versa...) will bring different preferences to bear and so bring different outcomes into effect..." (Hamlin 1990, p. 16).

The Paretian approach accords more closely with Hamlin's multi-preference approach than Brennan's approach. To Pareto real man is not any of the abstractions referred to as *homo oeconomicus*, *homo ethicus* or *homo religiosus*, nor *residues* and *derivations*, but the interactive sum of these abstractions plus the irregularities associated with 'concrete' phenomena which theory can not account for. Consequently, there is no logical inconsistency when preferences orderings of *homo oeconomicus* are contradictory to preference orderings related to residues etc. However, the task of reconciling concrete man's revealed preferences with those generated by Pareto's sociological model of man and relating this to his economic theory based on *homo oeconomicus*, is undertaken synthetically, which means limited precision.

VII Conclusion

If economics is to be used to evaluate or propose policies which require critical evaluation of revealed preferences, it can not do so with models based on the assumption that preferences are given, or that rationality of the actor should relate to the means employed to fulfil these preferences. This effectively defines the problems away, as is well recognised in *Rationality, Individualism and Public Policy*.

However, one of the most distinctive features of *Rationality, Individualism and Public Policy* is the role played by sentimental and unclear terminology. For example, the term merit good could have been devised by a marketing agency or a political lobby group. It is a double positive, a good good. Other equally sentimental concepts are true values and truer values.

By returning to the works of Pareto for inspiration, we find a rich theoretical basis within which preference manipulation can be analysed without resort to vague concepts derived from sentiment (ie. derivations). It also redresses many of the problems identified in the critique of welfare economics, but without abandoning its core foundations. While consumer sovereignty may be a policy goal, realisation of the goal in all circumstances would not be an ideal outcome. Given the heterogeneous nature of individuals within society, and the importance of utility interdependence, maximisation of utility of the community will not always correspond with conventionally defined Pareto optimal policy.

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Notes

- ¹ For a fuller treatment of ophelimity and utility see Tarascio (1969).
- ² See McLure (1996) for an overview of Pareto's *homo aeconomicus*.
- ³ Since many of the subsequent issues related to the provision of merit goods go beyond irrational action, the concept has been considered further in section V.
- ⁴ Parsons notes that Pareto's utility of the community implies a common system of ends and "marks a radical difference from the sociological individualism usual in the positivistic tradition" (Parsons 1968, p267). Economists would also agree, that politically assessed interpersonal preference comparisons mark a deviation from methodological individualism.

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