

Externalities and parentalism: a discussion of the merits and demerits of societal and state intervention

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Mark Sykes takes a look at apples, cigarettes and the nanny state in his entertaining overview of externalities and how to deal with them. In this normative analysis, Sykes analyses the age old tension between individuals and the state. Ultimately, he concludes that unless the negative externality imposed by one group on another is very large, attempts by the state to reduce it are likely to do more harm than good.

Introduction

Externalities are present at every level of human interaction: individuals, companies, charities and nations alike, can confer either or both positive and negative externalities on each other through their actions (Varian, 1992). The solution to these externality problems can either lie in coordination between the effecting and affected parties, so called ‘private’ solutions, or they can be resolved through coercion from a higher power that is: ‘public’ solutions. Note that the absence of a ‘global government’ means there are no pure examples of public solutions to international externality issues. The European Union (EU), and in particular the proposed European Monetary Fund is perhaps the closest in seeking to mitigate externalities of fiscal imprudence in a common currency area¹.

This article will deal primarily with questions surrounding externalities at the individual level, before going on to discuss the conditions for private and public solutions. Importantly, the third option for dealing with an externality will be

¹At the time of writing details of this plan are just emerging, see for instance: “Eurozone eyes IMF-style fund”, *The Financial Times* and “Brussels ready to back monetary fund”, *The Financial Times*

considered: inaction. That is, the case when the costs on individual liberty of acting against an externality outweigh its offence on others. That said these arguments, with limited adjustment can be up-scaled to other levels. Issues regarding individual liberty are roughly equitable to sovereignty issues on behalf of a country. Let us not forget, that the problem of one person's behaviour negatively affecting ten people's well-being is entirely symmetric to that of a country of five million people's actions adversely affecting the well-being of the entire world. For completeness, it is worth defining precisely the term externality as:

“A cost or benefit not expressed in the market and therefore not internalized in buyers' or sellers' market decisions”

(Hillman, 2009: 309).

Finally this article examines the concept of paternalism or parentalism. This concept is more difficult to pin down without making a normative judgement but two differing viewpoints are:

“The paternalist believes in coercion, in the forcible raising of taxes and the collective management of resources by a supposedly enlightened elite”

(Prowse, 1998:392)

“A policy is 'paternalistic' if it tries to influence choices in a way that will make the choosers better off, as judged by themselves.”

(Thaler & Sunstein, 2008: 5)²

As with externalities, parentalism will be dealt with primarily from an individual perspective, with reference to governmental or community group parentalism. However, as before, the issue is scalable. That said in this case there is no shortage of international examples of parentalism across the ages, ranging from colonialism, to arguably the United States' and United Nations' foreign policy³.

²Note, Thaler and Sunstein (1980) are trying to argue for 'Libertarian Paternalism' rather than the traditional hard paternalism discussed by Prowse (1998). It shall be argued later that this is somewhat oxymoronic.

³ See as an example: Sen John Mc Cain (R-Ariz,) statements on CBS news. “The U.S. has a moral obligation to support Iranians.”

In summary, throughout this article the concept of an externality and the scenarios in which it should and should not be dealt with either by society or the state will be explored. This article seeks to demonstrate the many dangers of intervention using both contemporary and historical examples. Furthermore, it will be argued that such is the magnitude of the dangers to individual liberty that in the vast majority of cases externalities should be endured, rather than a correction for them attempted. Similarly, it will discuss the arguments for and against parentalism, demonstrate the inconsistencies endemic within, and argue that opinions around parentalism are always the result of a value judgement. This will be the case whether one believes the individual is ‘good’ or ‘bad’, whether individuals have faith in human beings’ ability to act rationally and with compassion or whether one feels behaviour should be coerced or ‘nudged’⁴ by a benevolent intellectual elite.

Basics: what is an externality?

As discussed above, the term externality describes the situation where an action by an individual or the interaction between multiple parties imposes either costs or benefits on third parties. Clearly this term is extremely broad and it is possible to argue that nearly every activity confers an externality on someone, however minute. When persistent smoking in the presence of a child significantly increases the probability of that child contracting lung cancer in the future, the externality is undoubtedly large (Hirayama, 2000)⁵. When a person eats an apple on the train and offends the sentiments of a nearby passenger it is surely smaller. When individuals respire they contribute to global greenhouse gas emissions and thereby confer a negative externality on the current and future population of the world, an externality, but an infinitesimally small one⁶. Thus, the key issue with regard to externalities is not the detection of their presence but their quantification in comparable terms so that one may deduce the correct response in each individual instance. Few would argue on principle against some way of deterring smoking in the presence of a child, whereas it would be tantamount to lunacy to argue for regulation of the breathing

⁴Referring again, of course, to the overall concepts of Thaler & Sunstein (2008).

⁵For details on the harm to others of smoking see: A study of non-smoking wives of smokers, (Hirayama,2000), a cross sectional study of second hand smoke in Bars in the UK, (Edwards et al, 2006)

⁶For aggregated evidence see (Stern, 2008), specifically “Greenhouse gas (GHG) emissions are externalities and represent the biggest market failure the world has seen. We all produce emissions, people around the world are already suffering from past emissions, and current emissions will have potentially catastrophic impacts in the future.” (Stern, 2008:1)

habits of the population of the world. (This example is not so ludicrous when the substantial contribution the excrement of cattle makes to global greenhouse gas emissions is considered)⁷.

As such, a tool is required for comparing the benefits and costs of these interactions upon individuals of different values and desires. This tool is the concept of utility.

More advanced: what is utility? Are human beings rational? And what sort of society do people desire?

For the purposes of this article we shall need to create our own broad and malleable definition of utility. As such, we shall roughly equate it to be what we would call happiness or satisfaction. Assuming individuals suffer no mental disorders or dependencies, any activity which they freely engage in should increase utility, either in terms of satisfaction gained directly from the activity or from the compensation received from engaging in something from which disutility (work) is incurred. It is not too far a leap to suggest that this idea forms the backbone to both modern economics and liberalism⁸.

Under the above assumption, when consumers buy something, they should be better off than they were prior to the purchase. Buyer regret is, of course, possible when the actual utility offered by the purchase does not match-up to initial estimates (Cohen & Goldberg, 1970). Here the argument inevitably veers towards the concept of bounded rationality, behavioural economics and arguments regarding state intervention to correct for these ‘mistakes’⁹.

⁷For a further discussion, see “Livestocks Long Shadow, environmental issues and options,” a 2006 report by the Food and Agriculture Organisation of the United

⁸For an illustration of these combined ideals see Friedman and Friedman, 1990: 2.

⁹For a primer on the concepts consider Ariely (2008) or Thaler and Sunstein (2008).

Unfortunately for people's decisions regarding externalities, everyone has varying ideas about what constitutes happiness, morality and appropriate activity. As such, the concept of utility requires a more thorough examination. Is utility or happiness simply the satisfaction of animal needs, a quest for endorphins and other hormones which inflate a sense of feeling at a moment in time? Or is utility a broader concept, including the benefits of intellectual pursuit, meaningful social relationships and the technological, ethical and social advancement of race? This question becomes important when considering what the right course of action is when it comes to the consumption of drugs and other such actions which satisfy biological desires but do little to advance society. Mill (1867: 14) for instance opted for the broad concept of utility¹⁰:

"...it is better to be a human dissatisfied than a pig satisfied; better to be Socrates dissatisfied than a fool satisfied"

There is no simple answer but it is easy to see how the broader concept of moral utility could be used to justify all sorts of parentalism on the grounds that the use of drugs and other stimulants does not enhance true happiness, true utility.

Consider a society in the future where technological advancements allow human beings to live in an induced euphoria, with robots tending to nutrition and procreation needs. Consider in fact that the drug in question leads the mind to believe our greatest fantasies are being fulfilled. Whether individuals consider this state a utopia or a hell will determine the concept of utility.

What of societal intervention?

For the purposes of this analysis, let us assume that the true concept of utility is somewhere in between the two alternatives outlined above. People do not simply crave animal pleasures but they are not discounted entirely. So what of the externalities imposed on society? Does society have an obligation to deter individuals from their actions when sentiment is offended? Falling short of state regulation, when someone eats an apple noisily on a crowded train, is it not the moral obligation of another passenger to explain their difficulties with the behaviour and attempt to deter it? Should it be the obligation of all parents and educators to instil in the young awareness of and sensitivity to the implications of their actions on

¹⁰The concept of a broad definition of utility permeated much of Mill's work, specifically (Mill, 1867) and (Mill, 2005).

others? Intuitively, the answers to all these questions is yes; all individuals should, through their conduct, seek to maximise utility for society as a whole, be it through exercising restraint when certain behaviour may offend others, or by speaking up when offended. Surely, these solutions are at least preferable to state intervention, which threatens to constrain liberty further and seeks to compel behaviour rather than politely deter.

Unfortunately, when one considers the actions which imposed negative externalities on others in the past this answer becomes less appealing. Proponents of gender, racial, religious and sexual equality arguably all incurred significant mental anguish upon those they offended. These issues are not historic: blasphemers in Ireland today can be fined up to €25,000 for offending the sentiments of religious groups (Defamation Act, 2009)¹¹. Any idealist who goes against the prevailing social norms of the time is likely to offend the sentiment of the conservative society of the day. As such, one should be weary of imposing the will of the majority upon those individuals whose expressions or actions offend, when history has shown past beliefs of the majority to be ‘immoral’ by the compass used today. Consider for a moment how future generations may look back in dismay at the current outlawing of blasphemy, gay marriage or even bestiality. There is no way of knowing what will be termed correct by the moral compasses of the future, so it is the obligation of society to listen to all points of view despite the considerable psychic costs they impose on others. Of course, there are many areas where externalities are physical in nature, such as the case of noise or air pollution but outside of these, mental anguish must by and large be endured.

So what of state intervention?

Clearly there are many externalities which cannot be appropriately dealt with via societal interaction alone. In many cases, due to the numbers of people affected, and so-called ‘free rider’ problems, the state is required to intervene¹². However, it must also be noted that in many cases state and societal measures are substitutable. For instance, support for the needy and destitute is often regarded as an important state function because of the issues inherent with ‘free rider’ problems. However, without

¹¹Specifically: Section 36 (1) “A person who publishes or utters blasphemous matter shall be guilty of an offence and shall be liable upon conviction on indictment to a fine not exceeding €25,000.”

¹²That is a public good can be seen as one which is 'all externalities', non-excludable and non-rivalrous. For detailed discussion see (Hillman, 2009: 138-242)

state intervention community philanthropy can often fill this void and, arguably, do so more effectively. The USA, depending on personal inclination, can either be seen as a good or bad example of this¹³. That said it is easy to see how a community-funded safety net could perform better than a state provided 'one size fits all' approach. Residents are likely to be more inclined toward action as the benefits are more tangible. The programs could be adopted to suit the needs of the individual communities and a greater sense of community and social cohesion could result. Similarly, private solutions, in being closer to the issue, could encounter less issues of asymmetric information than a state solution. Put crudely, if people provide charity to someone in their locality they will find it easier to tell if they are exerting effort to improve their situation or falling victim to moral hazard than a government bureaucracy.

Note also that state intervention in the arena of externalities does not imply provision. The concept of internalising an externality in a voluntary exchange refers to adjusting the costs and benefits of the transaction to more accurately reflect its effect on society (Varian, 1992). As such, pigovian taxes and subsidies could efficiently provide the correct incentives in the areas of health and education to facilitate private provision. As an aside, none of the market failures present in health and education imply state provision, equity can be dealt with by subsidies to the poor and asymmetric information can be remedied by the provision of information.

Given that many state interventions deal with externalities in a way which also reflects prevailing social norms, the same pitfall which was present in societal solutions is also present here. Popular support alone for state intervention in rectifying a proposed externality does not make it just. The state is also more likely to carry out actions under the guise of dealing with a negative externality for what are, in reality more subversive means. This is due to the incentive structure in a democratic political system where interest groups can set the agenda and impose its will upon the masses.

Consider for instance many of the recent 'pro green' policies enacted by the Irish Government under the premise of combating the externalities of global warming. Banning 'inefficient' light bulbs (Hoskins, 2007) rather than levying a pigovian tax on them, as is the case with plastic bags, undoubtedly reduces the overall utility of society, in that it denies people the freedom to choose. That said proponents of the ban could argue for the need to change behaviour and social

¹³ Bremner (1988) provides a narrative explanation of the history of American philanthropy and its great tendency to increase over time.

norms. However, in that case the policy is paternalistic and thus has nothing to do with externalities.

In many cases state intervention will be necessary to correct for externalities. However, this is not the whole story. The state may be warranted in taxing tobacco as such consumption can impose significant negative physical externalities on third parties; however, a greater social willingness to speak up when personal happiness is impaired, as well as better education of smokers to consider the effects of their actions could be a better solution. Indeed, these may only occur in the absence of additional taxation on tobacco. Any other argument for the taxation of tobacco is paternalistic or based on revenue grounds.

Parentalism

Parentalism as a concept borrows from the interactions of a family whereby the head of the family may make decisions on behalf of others for their own good, even if it is against individual wishes. In a state context, a contrast can be drawn between hard paternalism, whereby freedom is entirely diminished because of banning and coercion, and soft paternalism which seeks to help individuals make the decisions they would ideally make, if only they had sufficient will power and foresight.

Thus far, the ideas expressed are similar to those of John Stuart Mill (2005). It is only appropriate at this juncture to express his thoughts on this matter exactly:

“But neither one person, nor any number of persons, is warranted in saying to another human creature of ripe years that he shall not do with his life or his own benefit what he chooses to do with it. He is the most interested in his own well being: the interest which any other person, except in cases of strong personal attachment, can have in it is trifling compared with that which he himself has...”

“... considerations to aid his judgement, exhortations to strengthen his will may be offered to him, even obtruded on him by others, but he himself is the final judge. All errors which he is likely to commit against advice and warning are far outweighed by the evil of allowing others to constrain him to what they deem his good.”

(Mill, 2005: 93)

Parentalism, by its very definition presupposes the fallibility of mankind but it argues that a collection of these fallible men acting on behalf of the masses will come up with better results than the individuals themselves. However, the interest an individual has in advancing his or her own cause and that of loved ones, coupled with the inherent asymmetries of information make this argument entirely untenable. In fact, evidence as to the fallibility of man only goes to rationalise decentralised decision making. History is riddled with the results of fallible beings creating and harnessing the power of large centralised states for the greater good only to impose devastating outcomes on minorities and others who did not conform to the prevailing social norms of the time. As a small sample consider: Nazi Germany, the pre-Reformation Papacy or Cromwellian Britain. As such, the default starting position to action proposed on the grounds of parentalism must always be scepticism. First, it must be proved that a significant problem exists, whereby an individual persistently, and without learning, makes bad decisions on behalf of themselves and his or her family. Then it must be shown that the provision of information and advice rather than coercion could not adequately resolve the problem. Lastly, it must be proven that the harm of inaction would outweigh the costs on individual freedom and liberty of action. Only then can one consider intervention.

Conclusion

This article has sought to demonstrate the importance of individual liberty: the freedom to make decisions about one's own actions. While many externalities can be grave, the solutions can be of more detriment than the issues themselves. State intervention in particular can have perverse unintended consequences¹⁴.

One must be fearful of conventional wisdom for it is generally proven wrong in the end. Many detrimental effects of externalities could be prevented by enhanced social interaction. Only by becoming more aware and sensitive to the impact of individual actions on others can externalities be reduced. The state is necessary to deal with some externalities because many contain public good characteristics, however society should still be wary of policies which seek to constrain liberty on these grounds. Furthermore, individuals should be receptive to

¹⁴ For a local and topical example consider the outcome of Irish state intervention in the housing market, which aimed to encourage urban renewal and the provision of social and affordable housing, but which also encouraged property speculation (Berry, 2001).

opportunism by special interest groups to further what is paternalism under the guise of externalities.

Hard paternalism in and of itself is a false doctrine; to support it requires an elitist view which disregards the incredible decision making and coordination skills of the population as a whole. Soft paternalism must be approached with care: providing information to assist in better decision making is welcomed, particularly when the free market fails to do this. However, the barrier between nudging and coercing is a blurry one and the presence of asymmetric information means it is likely to remain so.

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