

*“Where Positive Meets Normative:  
Economics, Economists, and the Matter of Harm”*

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If it were known to be true, as a question of fact, that measures that cause misery and death to tens of millions today *would* result in saving from greater misery or death hundreds of millions in the future, and if this were the only way in which it could be done, then it *would* be right to cause these necessary atrocities.

--J.J.C. Smart 1973 (emphasis in original)

## **Introduction**

In *The Economist's Oath* I discuss in passing the matter of the harm that attends economic practice. Other professions with established bodies of professional ethics take seriously the imperative to theorize the harm they induce, and to take steps to avoid preventable harm. In contrast, economists generally do not generally give much thought to the nature of economic harm; or to the ways that their own practice induces harm. In part this may be due to the fact that economists recognize that harm is a regular feature of economic practice, and so the Hippocratic directive “first, do no harm” has no relevance in economics. I return to the idea that harm inheres in economic practice below. But it also stems from the allergy of the economics profession to professional ethics in general, and to professional economic ethics in particular. This situation is intolerable: the relative neglect of their professional duties allows economists to undertake their research, teaching and applied work without sufficient attention to the ways in which they can and do cause harm.

But do economists really cause harm—and even avoidable harm? In the book I argue controversially that on the most pressing economic policy issues of the past several decades, such as the matter of what is the appropriate regime for financial regulation and governance, leading economists have used their substantial authority to apply the “maxi-max” decision rule. Maxi-max directs us to implement that policy option that has among its possible payoffs one that is higher than the highest possible payoff of any other policy alternative, full stop (Nozick 1974). While maxi-max theorizes each policy option as a probability distribution of payoffs, and in that sense recognizes risk, it discounts risk entirely in policy choice since it ignores the possibility of policy regime failure.

Financial liberalization was pursued on precisely these grounds, though no one of course spoke of maxi-max or even recognized its implicit presence in policy choice. It was advocated across the developing and developed country context, without qualification or nuance, in the belief that it promised a higher payoff than any alternative financial regulatory regime. In advocating financial liberalization the profession apparently forgot that there are no free lunches; that those strategies that promise the highest possible return also entail the greatest risk; and that in pushing for this regime it placed economic welfare at risk. I argue that no imaginable body of professional economics ethics, were it to exist, would permit such risk taking with the lives of others.

But while the book engages the matter of harm, I was aware when writing it and have been increasingly aware since that the book's treatment of "harm" is terribly inadequate. When one begins to think about harm at all carefully, one comes to realize that harm is a complex concept. First, harm is internally heterogeneous. Harm can take the form of dismemberment or the loss of physical and mental faculties; psychological or emotional suffering; impairment in the pursuit of one's life plans; a loss of creativity, inventiveness or playfulness; a loss of meaningful connections with others, or of community (Marglin 2008); the destruction of a valued way of life, or loss of political efficacy (Sen 1992); and many other forms besides. Harm may also occur without inducing any physical pain or disability, or any mental discomfort (such as unhappiness). Indeed, harm can occur without the harmed agent even recognizing it, as in the case of "adaptive preferences" (see below). The internal heterogeneity of harm can render problematic the specification of what does and does not represent harm, and the extent of harm, at least in complex (but likely common) cases.

Second, the concept of harm relates in complex ways to central features of social existence. An agent suffers harm when his welfare, agency, relationships or rights are undermined. This implies that an adequate account of harm presumes an adequate account of these salient features. For instance, a good/full account of harm almost certainly requires a good account of human needs and subjectivity (and subjectivity formation), and of human relationships with others and with their natural and social environment. It also may require an adequate conception of human rights, freedoms and liberties.

Third and finally, all of these antecedent matters are contested. Different philosophical and economic frameworks will and do disagree about just what effects register as harm. And this fact implies that the concept of harm is also, invariably, contested. A libertarian and a utilitarian will be apt to disagree sharply about the nature of harm, which harms are substantive and which are *de minimis*, and which forms of harm are ethically worrisome. And so it is the case that *positive* analyses of the concept of harm, such as assessing when harm has occurred and measuring its extent, is thoroughly infused with *normative* judgments. We need to make normatively charged decisions about what counts as harm; and we then have to follow up with normatively laden decisions about which of the harms we recognize are to be taken as ethically indictable, and which are not. All of this implies that as regards the matter of harm, if not everywhere else in economics, the positive and the normative are inescapably linked. Talk of harm is necessarily at once positive and normative. This may help to explain why economists have been reluctant to give sufficient attention to the matter of the harm that attends economic interventions, flows and outcomes.

In what follows I will offer and explore just three basic propositions. The first is that economic practice necessarily induces harm. Second, the predominant approach to harm theorization in economics is terribly inadequate for a profession that takes seriously its ethical duties. Third, careful engagement with economic harm requires examination of a wide range of conceptual (and practical) issues. To make that point I will explore in passing just a few of the questions that pertain to the harm that economists do when they try to do good.

## I. Economics in the Harm Business

The duty to engage economic harm is imposed upon us by the nature of economic practice. Harm to those whom economists purport to serve results most obviously from error in economic judgment—such as when an economist fails to anticipate the unintended adverse consequences of a proposed economic intervention. This is an apt description of Alan Greenspan’s stunning admission before Congress in the fall of 2008 of his own naïveté in believing that unregulated financial markets would police themselves sufficiently so as to prevent irresponsible and destabilizing behavior. “I made a mistake in presuming that the self-interest of organizations, specifically banks and others, was such that they were best capable of protecting their own shareholders.” Speaking of a “once in a century credit tsunami,” he continued, “[t]hose of us who have looked to the self-interest of lending institutions to protect shareholders’ equity, myself especially, are in a state of shocked disbelief” (Andrews 2008).

But Greenspan is by no means exceptional in this regard. His failure reflects a deep (and likely ineradicable) knowledge problem in economics. Economists operate in a world of epistemic insufficiency, where they largely cannot know what will be the full range of effects of the interventions they advocate. The effects of economic interventions can be extraordinarily dispersed and extend indefinitely into the future. In this regard, economics is akin to the field of environmental practice rather than medicine or other fields that operate on smaller canvases, treating clients one at a time, and where the effects of an intervention are relatively localized. Epistemic insufficiency implies that even well-meaning and adept economists risk doing substantial harm as they try to promote social welfare.<sup>1</sup>

Making matters worse, economists cannot control the world in which they operate. There can be and often is substantial slippage between policy recommendation and policy effects owing to unforeseeable vagaries in the policy making and implementation process, and in the responses of economic agents to any policy alteration. Even in those unusual instances where economists occupy the role of social engineer—such as in the economic restructuring projects in the post-socialist context, where leading economists at the IFIs, government agencies and think-tanks were able to engage in institutional design—economists enjoy *influence without control* (DeMartino 2011). Not least, the policies that economists advocate can be hijacked by special interests for their own ends and/or otherwise undermined in execution, or in the response of the private actors populating the economy. More generally, in the policy arena politics and not economics typically are in charge. Finally, the effects of any intervention will depend on innumerable factors pertaining to the economy about which the economist’s knowledge is

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<sup>1</sup> Economists are by no means alone in facing severe limitations to their expertise. Philip Tetlock’s study of the ability to predict across the professions provides remarkable evidence of consistent failure. In his words, “When we pit experts against minimalist performance algorithms—dilettantes, dart-throwing chimps, and assorted extrapolation algorithms—we find few signs that expertise translates into greater ability to make either “well-calibrated” or “discriminating” forecasts” (Tetlock 2005, 20).

at best quite limited, as just discussed. All of this implies that economic practice is fraught with uncertainty and with the risk of perhaps substantial unintended and unforeseeable harm.<sup>2</sup>

Harm resulting from error—or more broadly, from the imperative facing the professional to act under conditions of epistemic insufficiency, in a world that defies dependable prediction or control—is perhaps a universal problem in the professions. Its salience in economics represents a difference in degree rather than in kind. But economists cause harm in other ways that may be *sui generis*. Economic interventions generally entail disparate effects across society's members. It appears to be in the nature of economic systems that even well-designed economic interventions almost invariably cause harm to some economic actors. Think of the neoclassical case for the removal of trade barriers (or the Marxian case for class emancipation). In this case, which is representative of economic policy interventions in general, some in society benefit from trade liberalization while others necessarily suffer economic harm.

Economics is unlike many other professions in two relevant senses: the degree to which harm inheres in its practice; and in the distribution of the harms it induces. In medicine, for instance, serious harm typically arises from medical error or from the limits to medical knowledge of physiological processes. In economics, in contrast, harm is an inherent feature of even successful economic interventions; it can occur even when the economist gets it right. Moreover, medical harm typically afflicts the agent whose welfare the doctor seeks to improve, and perhaps those others who are closely related to the agent and who value or are dependent upon his or her welfare. Not since the infamous Tuskegee experiment came to light has it been thought legitimate (in the US) to impose substantial medical harm on some for the benefit of others.<sup>3</sup>

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<sup>2</sup> Colander's distinction between the "economics of control" and the "muddling through" approach to policy work is relevant here (2005). Colander argues that the profession has held to the economics of control approach in its practice and pedagogy for far too long. Recognition of the inherent complexity of economic systems implies the need to move away from the illusion of control over the outcomes of policy interventions; and to approach policy design and implementation in a pragmatic way.

<sup>3</sup> Though third-party harm can arise in the context of public health, where decisions affect large groups of people rather than individual patients one at a time, and where effects across the relevant population can be disparate. Public health may indeed have more than traditional medicine to offer economics as it begins to struggle with its professional ethical duties.

Of course, one could argue that medical practice imposes harm on others also by virtue of opportunity costs: the resources that are allocated to one patient are unavailable for the treatment of others nearby who need medical assistance in the same moment. Indeed, where resources are particularly scarce harm of this sort may be significant. But the extent of that harm is a consequence of contingent circumstances associated with the level of economic development, the features of the system of health care provision, and the like. The fact remains that harm to some is not wired into any particular medical intervention. Some can be (and generally are) helped without necessarily harming others.

*In contrast economics is, inescapably, in the harm business.* Economic harm is a routine feature of economic policy implementation, even in the absence of error. Harm arises whenever a policy that promotes aggregate economic gain also worsens the situation of some members of the economy.<sup>4</sup> While politicians often claim that their preferred policies benefit all of society's members, economists know better. Virtually all micro- and macro-economic policy interventions have disparate impact, and many involve actual harm. Helping some routinely requires hurting others; that is the tragedy of economic practice.

The fact that economic practice generally induces harm to some while benefitting others implies that the profession faces a heavier ethical duty to engage harm than do other professions where harm is not as salient a feature of professional practice. The burden lies heavier on the shoulders of economists, then, than engineers, accountants, and even physicians. But of course, we find no tradition of serious inquiry within the profession into the nature of economic harm. Economics treats harm too casually, perhaps out of an inchoate anxiety that facing up to economic harm in a serious and rigorous way, attending carefully and fully to the claims of those who will be adversely affected by economic interventions, would complicate economic practice to such a degree as to render it untenable.

## **II. The Predominant View: Welfarism, and the Kaldor-Hicks Compensation Test**

The predominant approach to harm and harm mitigation in economics reflects the utilitarian framework from which neoclassical economics draws its normative foundations. Neoclassical economics carries forward the consequentialism of utilitarianism, along with its evaluation of states of affairs by exclusive reference to the levels of welfare of the agents affected by those states. Welfarism can and has been defined variously in neoclassical thought as levels of utility or, more frequently in recent history, the extent of preference satisfaction (Sen 1987). Unlike traditional utilitarianism, neoclassical thought does not allow inter-personal utility comparisons or, consequently, the summation of utility levels across distinct individuals. Social assessment depends instead on the Pareto criterion and especially on the Kaldor-Hicks compensation test.

The textbook neoclassical approach to normative assessment depends on comparisons of absolute levels of welfare (defined on an ordinal scale); and tends to include as arguments in each individual's utility function only his/her own level of consumption or the satisfaction of self-regarding preferences (Sen 1987). Consider a worker who is displaced by a shift in economic policy, such as the removal of tariff protection. In the simplest textbook treatment of the problem, only the loss of the worker's income registers in the harm accounting. In broader formulations other harms that are associated with

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<sup>4</sup> Hence, economic harm is by no means restricted to zero-sum situations.

unemployment can be figured in, of course.<sup>5</sup> These might include physical ailments and psychological damage to the worker, increased incidence of suicide and crime, and declining asset values (such as housing prices) that attend the policy shift. But in keeping with the utilitarian tradition that underpins neoclassical thought, all of these damages are treated as reducible to impacts on the worker's welfare. Moreover, the diverse contributors to the worker's level of welfare are taken to be fungible. Indeed, substitutability among arguments is a common feature within utility functions (and within models of preference satisfaction). These features of neoclassical thought imply that the damages are taken to be fully commensurable with each other and with a sum of money, and this reasoning in turn permits the conclusion that the damages can be fully compensated through a monetary transfer. Under the predominant welfarist approach, any welfare loss may be fully offset through monetary compensation. Full compensation, then, simply requires finding the appropriate magnitude of monetary transfer that will restore the displaced worker to his previous level of welfare (or preference satisfaction). If full compensation is made, the worker is taken to suffer no harm from the loss of employment.

Unlike the pareto criterion, the usefulness of which is limited in economic application owing to conflicting preferences across possible social states, Kaldor-Hicks is taken to provide a fairly tractable framework for reaching unequivocal, objective judgments on economic policy whenever harm is apparent. That policy is preferred that is Kaldor-Hicks efficient (where the winners can fully compensate the losers and retain net benefit). Hence, Kaldor-Hicks seems to imply an appropriate ethic for the applied economist. The economist should advocate those policy interventions that pass the Kaldor-Hicks compensation test, and refrain from advocating those policies that fail the test. Though economists would likely recoil from the full implications of this approach, as reflected in the epigraph to this paper, many economists do believe themselves to be warranted in advocating policies that induce harm in order to augment aggregate welfare.

### *Inadequacies of Welfarism and Kaldor-Hicks*

Kaldor-Hicks raises several issues that pertain to harm, some of which have been long debated among economists.<sup>6</sup> One is the question whether potential compensation is sufficient to warrant a policy intervention—or whether, as a condition for the economist's support, the losers under a Kaldor-Hicks efficient policy intervention must actually

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<sup>5</sup> This is the norm in benefit-cost analysis, where all manner of effects of alternative policy interventions can be and are factored into policy assessment, but only as determinants of individuals' levels of welfare.

<sup>6</sup> Several controversies surround the use of Kaldor-Hicks that I will not examine here. Marxian, Austrian and other heterodox traditions largely reject the Kaldor-Hicks test—in part owing to their appreciation of the endogeneity of preference (and subjectivity) formation (to which I return below). See, for instance, Stringham (2001) for an Austrian critique of the use of Kaldor-Hicks in the judicial setting. See also Sen (1979) and Scitovsky (1941) for critiques that have emerged within the tradition of welfare economics.

receive full compensation for their losses. Hicks thought that potential compensation was sufficient; Posner and many economists concur (citation here). In contrast, Jagdish Bhagwati (1994) has maintained that actual compensation is necessary, and he chastises those members of the profession who believe that it is sufficient for the applied economist to demonstrate potential compensation on the blackboard, rather than advocate full compensation in the world where policy adjustments occur. Rodrik (and others) point out that in fact full compensation rarely occurs.<sup>7</sup> Absent actual compensation, Kaldor-Hicks policy adjustments generate anticipated harm where it is (in principle) avoidable. And yet economists tend not to think through carefully what might be their obligations to those who populate the economy when their practice induces foreseeable harm.

A second issue is the narrow definition of harm that Kaldor-Hicks embraces, to which I've alluded above. In application, only absolute losses and gains typically register in the economist's ledger. Omitted here, for instance, is concern for economic inequality since a policy that increases inequality is just as apt to pass the Kaldor-Hicks compensation test as a policy that has the opposite effect. Indeed, Kaldor-Hicks is agnostic in regards to inequality. That increasing inequality might harm the losers from a policy shift, beyond the harm suffered by an absolute decline in their incomes, is routinely ignored in applied welfare economics—such as in policy debate. Hence, it is also ignored in calculating full compensation.<sup>8</sup> But economic inequality may induce all manner of harms, as Sen, Veblen, Marx and countless other theorists have by now argued at length (see below).

Third, the welfarist approach underlying Kaldor-Hicks also tends to overlook conceptual distinctions that figure prominently in serious investigations of harm beyond economics, and that ought to be engaged in investigations of economic harm. One of particular relevance concerns the difference between “direct” and “indirect” harm. The legitimacy of indirect harm is sometimes theorized under the doctrine of “double effect,” some formulations of which claim that

sometimes it is permissible to cause such a harm as a side effect (or “double effect”) of bringing about a good result even though it would not be permissible to cause such a harm as a means to bringing about the same good end (McIntyre 2011).

An example of direct harm in the economic context is anti-trust or open-shop legislation, where benefits enjoyed respectively by a corporation or a labor union are targeted for elimination in order to promote aggregate social welfare. Eliminating the corporate or union privilege, in this case, is the intended *means* to bring about the desired end. An example of indirect harm is the loss of corporate competitiveness and employment following trade liberalization. Here, the harm to the corporation and its employees is not

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<sup>7</sup> Strangely, this evidence has not dissuaded many Bhagwati from advocating harm-inducing policy shifts.

<sup>8</sup> Utility functions are often defined in ways that rule out “envious” preferences, which largely eliminates consideration of inequality from welfare computations. (citations here)



the means to the end; it is instead a foreseeable but unintended result of the goal of increased economic welfare.

Philosophers are not alone in emphasizing the ethical salience of the distinction between the two kinds of harm. Experimental studies reveal the presence of an “indirect harm bias” among research subjects—harms that come about as an unintended but foreseeable byproduct of an act are treated as less ethically troublesome than are direct harms that are the means to the end being pursued (Cushman, Young and Hauser 2006). This is a case where philosophy and intuition line up; and this provides the concept with greater *prima facie* plausibility than it might otherwise have.

The double effect doctrine would seem to be of greater relevance in economics than in those professions where doing good does not so directly entail doing harm. The situation facing the economist is often precisely of the form that is presumed in the double effect doctrine, which is:

directed at well-intentioned agents who ask whether they may cause a serious harm in order to bring about a good end of overriding moral importance when it is impossible to bring about the good end without the harm McIntyre (2011).

But in fact, economics makes no distinction at all between these two kinds of harm. Both kinds of harm are to be judged exclusively by their effects on aggregate welfare. Whether the harm serves as the direct means to the desired end, or simply as an unintended but foreseeable byproduct, makes no difference in welfarist accountings since it is the ultimate consequences, and not the action that brings about the consequences, that matter in this framework. Both kinds of harm are therefore equally likely to pass or fail the Kaldor-Hicks test (or the pareto criterion).<sup>9</sup>

Another distinction arises within the philosophical literature, between “doing” and “allowing” harm. Alternatively, the distinction is framed as between harm that results from acts of “commission” and harm that results from “omission,” or a failure to act. Are these two cases normatively distinct? Howard-Snyder puts the question this way:

Is doing harm worse than allowing harm? If not, there should be no moral objection to active euthanasia in circumstances where passive euthanasia is permissible; and there should be no objection to bombing innocent civilians where doing so will minimize the overall number of deaths in war. There should, however, be an objection—indeed, an outcry—at our failure to prevent the deaths of millions of children in the third world from malnutrition, dehydration, and measles (Howard-Snyder 2007).

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<sup>9</sup> I should add here that the principle of double effect is not universally accepted within philosophy, and that some opponents ground their critique in consequentialist reasoning. Like all such concepts, it is contested on multiple grounds.

The commission-omission distinction is theoretically contested and complex (see Howard-Snyder 2008). That said, the intuition that sustains the distinction is strong. Indeed, recent psychological studies indicate the presence of an “omission bias” among research subjects: all else equal, subjects will choose an equally bad outcome for others that results from inaction rather than acting. Moreover, subjects will sometimes choose a worse outcome for others that result from omission over a better outcome that results from acts of commission (Spranca, Minsk, and Baron 1991).

It is important to note that the omission bias informs not just unreflective judgments of research subjects in a laboratory, but also mature bodies of professional ethics. In medical ethics a distinction has long been drawn between assisting in the suicide of a patient who desires death, on the one hand, and refraining from resuscitating a patient who can no longer survive without constant technological support on the other. The medical profession’s resistance to assisted suicide reaches back as far as the original oath of Hippocrates, though for that long it has also been contested within the profession. Medical ethicists raise several distinct concerns regarding assisted suicide, such as worries about the slippery slope that may induce physicians to assist in suicides where that action is not warranted, once the practice is legitimized at all. But there is also in evidence in the medical ethics tradition a normative stance that disdains the practice of active harm. Moreover, there is evidence that practicing physicians tend to exhibit the omission bias (and the indirect harm bias) in their clinical work (Cushman, Young and Hauser 2006).

Just as welfarist consequentialism refuses to distinguish normatively between direct and indirect harms, so does it refuse to distinguish between harm that results from acts of commission and omission. The effort that philosophers and professional ethicists expend to sustain and theorize these distinctions begs the question whether economics has got it basically right in these regards. Should economics continue to discount entirely the difference between direct and indirect harm, and between harmful acts of commission and omission?

The answer to these questions are inescapably tied to judgments concerning whether economics ought to be partly or fully committed to welfarist consequentialism as its normative grounding. Both binaries place consequentialists at odds with advocates of alternative normative frameworks. Many traditions in economics reject welfarist consequentialism, ranging from Austrian economics on the right to Marxian economics on the left. Indeed, only the predominant neoclassical approach accepts welfarist consequentialism. And so the field of professional economic ethics, were it to exist, would likely yield a range of distinct voices on the matter of direct and indirect harm; on doing versus allowing harm. This is just what we find across the terrain of professional ethics: utilitarians spar with deontological, virtue, feminist and other ethicists over the full range of conceptual, empirical and normative issues that arise in the field.

In economics, and to take one example, the individual rights-based normative framework that sustains the Austrian approach is certainly more apt to draw an ethical distinction between instances of direct and indirect harm, as does the libertarian philosopher Robert

Nozick (1974). Indeed, the distinction that Milton Friedman (1962) draws between what he calls “positive” and “negative” harm in his discussion of racial discrimination overlays in some ways the direct/indirect, and commission/omission binaries. For Friedman, positive harm arises as a consequence of the use of “physical force, or by forcing [someone] to enter into a contract without his consent.” In this account, coercion is the decisive feature of positive harm. In contrast, negative harm “occurs when two individuals are unable to find mutually acceptable contracts, as when I am unwilling to buy something that someone wants to sell me and therefore make him worse off than he would be if I bought the item” (Friedman 1962, 112). In judging these two kinds of harm Friedman steps outside of the welfarist consequentialism of neoclassical thought, and draws instead on the rights-based framework that (also) informs his work. As he puts it,

There is a strong case for using government to prevent one person from imposing positive harm, which is to say, to prevent coercion. There is no case whatsoever for using government to avoid the negative kind of “harm.” On the contrary, such government intervention reduces freedom and limits voluntary co-operation (1962, 113).

Whether this is an appropriate way to theorize the harm that attends economic practice is something that should be sorted out in the field of professional economic ethics. An affirmative answer requires a willingness to break with the welfarist consequentialism of neoclassical thought—something that Friedman himself was only partially willing to do. His inconsistency on this matter no doubt reflects a broader unease in the profession about committing entirely to welfarist consequentialism—by centrist economists as well as by those on the right and the left. Not many economists would want to find themselves endorsing the extreme positions that are associated with an unbending welfarist consequentialism.

A fourth set of issues, which deserves attention but which is largely papered over in the consequentialist welfarism of neoclassical thought, is the question whether all benefits and harms are to be theorized as commensurable, and whether all harms are viewed as reparable and compensable. The three concepts are related, but distinct. Neoclassical thought encompasses commensurability, reparability and, hence, compensability. Absent either of the first two, the compensability at the heart of Kaldor-Hicks would be problematic. Incommensurability between other goods and money would render compensation difficult to theorize, let alone calculate and implement (see below). Irreparability likewise would call into question compensability since irreparable harm would imply that no subsequent transfer would be able to return an agent to his previous condition. After all, irreparability implies a loss that cannot be made good after the fact.<sup>10</sup>

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<sup>10</sup> In future drafts pursue the matter of irreparability further. To whom is harm to be taken as reparable or irreparable? E.g., consider the work of Grosskopf and Medina (2009) on theorization of irreparable harm within the law and economics tradition. For G and M, only dead-weight losses (to society) constitute irreparable harm (since, in a world of scarcity, dead-weight losses can’t be restored in the future). [Loss of a worker’s life, in contrast, would not represent irreparable harm provided production requires risk of harm

### III. Economic Harm: A Complex View

Within and beyond economics theorists have examined the complexity and fullness of harm. Analyses break with the central features of the neoclassical view on several levels. Not least, they appreciate the multiplicity of forms of harm; they reject the idea that diverse harms are commensurable and reducible to any one metric, such as welfare; and they simultaneously reject the idea that harms are necessarily reparable, or fully compensable through monetary transfers. For present purposes, I'll examine just two lines of inquiry that break with the traditional economic approach. Both arise within heterodox traditions in economics.

#### *Elster and Adaptive Preferences*

As many have by now argued, traditional economics takes rationality to be a universal essence, and then derives from that quality of human nature the idea of relatively stable preferences that are formed independently of agents' *economic* activity. We do not know or care about the origins of preferences—that is taken to be a non-economic question since preferences are presumed to be formed exogenous to economic processes, institutions and behavior. We hold that the rational agent already knows what s/he prefers prior to his/her economic engagement, that these preferences are true or dependable in some deep sense, and that the agent then acts in the economic domain to satisfy her most important preferences. She knows best—that is a fundamental axiom of economic science—and she is not to be distracted from the pursuit of her deepest interests as she defines them by the economic circumstances of her life.

But what if preferences and perhaps even the deeper subjectivity that give rise to preference formation are constituted also and in part through one's economic activity—as many institutionalists, social economists, feminists and Marxists claim? What if, for instance, one's immersion in a market economy inculcates certain subjectivities and thwarts others? Jon Elster (among many others) has emphasized the endogeneity of preference formation in his work, and one point in particular relates directly to the matter of harm. Elster argues that it may be the case that those who are economically oppressed subconsciously alter their preferences in line with what is available to them, by discounting the desirability of states or conditions that they take to be unobtainable. "Adaptive preferences" arise when individuals come to believe that in fact they do not desire those things that they cannot have. The distortion of their preferences and the revision in their antecedent beliefs might even become embedded and diffused within the cultural beliefs of an oppressed community. Children maturing in such a milieu may very well adopt the adaptive preferences of their communities, and fail to express a desire for the fruits that lie beyond the community's grasp. There are affinities here with the

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to workers, and workers have bargained freely for a risk-compensating wage differential. In that case, the death is a cost of doing business efficiently; and any interference with the right of the business and workers to reach agreement over this work would represent a dead-weight loss.] Consider also the work of Lichtman.

Marxian notion of false consciousness, of course, where those who are exploited come to share elements of the worldview of those who exploit them. This process of adaptive preference formation might allow the dispossessed to live fairly tolerable and happy lives in the face of even egregious injustices. I should add that those operating within the capabilities framework, such as Amartya Sen and Martha Nussbaum, likewise emphasize the problem of adaptive preference formation.

Adaptive preference formation presents normative problems not just for Kaldor-Hicks, but for the broader normative framework that grounds neoclassical thought. It may be the case that those who are harmed by a policy intervention might not suffer much psychic discomfort if they have already come to expect little from the policymaking enterprise. This problem would be most acute, of course, in those communities that are already most dispossessed and that face the greatest systematic deprivations of autonomy and political efficacy, since these are the communities where adaptive preference formation would be most prevalent and sedimented. And in this case, Kaldor-Hicks calculates little need for compensation—potential or actual—since there is little harm to those who lose from any particular policy intervention.

This example points to an aspect of serious harm that escapes attention in economics as a consequence of its holding to the exogeneity of preferences. Exogeneity of preference is a foundational claim in economics—but it is enormously consequential and, as this discussion makes clear, normatively salient. The assumption rules out adaptive preference formation, since it embodies the view that preferences are untouched by one's economic circumstances or the nature of the economic institutions that govern in one's community. As a consequence, the assumption of the exogeneity of preference orderings obscures a form of harm that comes about as a consequence of the structures of the economy, and the practice of economists. I should emphasize that this is not an insignificant form of harm. Indeed, if we find Elster's work compelling, as I do, then we are led to see that the obscured harm is fundamental, and indeed much more important ethically than the kind of harm that is recognized in neoclassical thought. After all, it is a far more egregious violation of a person's autonomy and substantive freedom to distort his subjectivity by diminishing his belief in the value of and hope for the possible, than it is to simply reduce his income, level of happiness or preference satisfaction. The unhappy and embittered victim of a policy shift remains free in a fundamental sense that is lost in cases of resignation to injustice. It would be wrong, therefore, to judge the desirability of states of affairs by evidenced level of happiness or the character of revealed preferences. Indeed, Elster identifies the paradox that attends any intervention that shatters adaptive preferences—that exposes to the oppressed that they should aspire to a social good that has been denied them. Such interventions at once expands the freedom of the oppressed while at the same time diminishing their level of happiness or satisfaction with the existing state of affairs. And in such cases, Elster is right to argue that we should valorize the gain in freedom over the loss of happiness in any social accounting. We should prefer situations in which the slaves are wildly dissatisfied rather than satisfied—where they are able to sustain and articulate an aspiration to emancipation at the price of unhappiness rather than where they have manufactured belief systems that in one way or another reconcile them to their servitude.

What is at stake in cases like this is the degree to which economic arrangements (and interventions) sustain or diminish personal autonomy and, to the degree that freedom depends on autonomy, freedom itself. An intervention that diminishes in one way or another the ability of economic agents to articulate and pursue their conceptions of a valued life, such as those that yield adaptive preferences, are indictable in this account even if they do not diminish agents' level of happiness or preference satisfaction. They are indictable because of the corrosive effect they have on those preferences—and on the autonomous subjectivity of agents.

Economic interventions and processes that diminish the landscape of the possible and the desirable, may be substantially undervalued in the economist's calculations of harms since they might yield adaptive preferences rather than explicit dissatisfaction. This is a part of what Steve Marglin worries about in his book *The Dismal Science*. Economic disruption of community may entail costs of a sort that are overlooked and even denied by an economic approach that takes human subjectivity and preference formation as exogenous to economic affairs. And in that maneuver, economics is able to wash its hands of very serious forms of harm that may often attend economic policy interventions.

### ***Sen, Nussbaum and Capabilities***

I pointed out earlier that the neoclassical Kaldor-Hicks framework largely takes diverse harms to be commensurable, repairable and compensable through monetary transfers. I want to take a moment to explore this issue briefly, by drawing on the “capabilities to achieve functionings” framework of human development.

Amartya Sen has argued repeatedly and at length that human development entails the ability to achieve many distinct functionings—including being well nourished, able to live a long and healthy life, and appearing in public without shame. The capabilities framework claims that full human development necessarily entails flourishing along all of these dimensions. The range and diversity of functionings reflects the inherent complexity of human nature, human existence and judgments about what it means to live a valued life. Moreover, Sen, Martha Nussbaum and others in this tradition argue that a functioning failure in one domain cannot necessarily be compensated (easily or at all) with enhanced functioning in another domain. For one thing, distinct capabilities are interdependent: one's capability to achieve along any one functioning dimension influences one's capability to achieve along others. For another, if we take seriously the complexity of human existence, we must also take seriously the idea that freedom and development require satisfactory achievement along many distinct dimensions. More than adequate housing cannot compensate for inadequate nourishment; nor can good nutrition compensate for inadequate political efficacy. Moreover, when we encounter structural factors that deny some groups in society political efficacy, we cannot take comfort in the fact that they are nonetheless well-fed, or even happy.

Nussbaum presses further than Sen is willing to do in specifying which functionings are vital to human existence. She presents a “thick, vague” account of the minimal

capabilities to achieve functionings that are required to live a life that can be regarded as a human life. These include *inter alia* being well nourished and sheltered, exhibiting a capacity for pleasure and pain and practical reason, the ability to affiliate with other human beings, and the ability to enjoy humor and play (Nussbaum 1992, 218-19). Nussbaum then offers a second level of interrelated capabilities that constitute the minimum floor for living a *good* human life. This list includes *inter alia* living “to the end of a complete human life,” having “good health,” “being able to avoid unnecessary and nonbeneficial pain and to have pleasurable experiences,” being able to “love, grieve, to feel longing and gratitude,” and “being able to live one’s own life and nobody else’s...” (Nussbaum 1992, 221-22).

The salient point to be drawn from the capabilities account for professional economic ethics is that economic structures, processes and interventions may induce diverse forms of harm, such as the loss of capability in any of the distinct domains that comprise a full human life. Moreover, and contrary to the welfarist consequentialism, these harms cannot be reduced to some common denominator that allows for full compensation via the provision of transfer payments. The loss of identity, confidence, sense of self as useful and productive, and opportunities for affiliation and recreation that may occur as a consequence of being rendered unemployed, for instance, cannot be made up simply with unemployment compensation—even if that compensation restores fully the income lost through the termination of employment. And in this case, the economist who proposes an economic intervention that passes the Kaldor-Hicks test may be indictable if s/she does not reach beyond the limited and simplistic metric of harm which that formula recognizes, to consider the more fundamental and potentially irreparable and non-compensable harms that economic interventions often induce.

### **Further Considerations on Economic Harm**

The foregoing represents the barest of beginnings of an adequate consideration of the nature of economic harm. If we take the idea of the complexity of harm seriously, we are led to a series of questions that I cannot begin to answer—but which must form a part of professional economic ethics.

Here I simply list a few.

*1. What are the diverse forms of economic harm, and which of these are compensable through monetary transfers or other means?*

The discussion of Elster and Sen and Nussbaum suggests that harm may very well take forms that are largely missed in traditional welfarist accounts; and that many of these may not be compensable through monetary transfer.

*2. Which forms of economic harm are ethically salient?*

Certainly, not all harm that we suffer is indictable, even if we feel aggrieved at the moment we suffer the harm. A thief who is forcibly separated from his illicit gains, which

he has taken to consider rightfully his, does not deserve compensation for his losses or even much ethical concern. But what about the beneficiaries of the thief, who benefited from the theft even if they did not participate in the theft or even know of its occurrence? For instance, what are we to make of the harm to the member of an ethnic or racial majority that occurs as a consequence of enforced taxation on the majority to fund reparations to a racial minority for past injustices? Such measures can also take the form of legislation that diminishes the opportunities facing at least some members of the racial majority, such as affirmative action in allocating employment or educational opportunities. This can be framed in the capabilities framework as an alteration in entitlements in favor of the dispossessed, in order to generate greater capabilities equality. Nozick's historical view of justice would have us discount this harm, provided its intent is simply to rectify a past violation of rights. Other historical accounts of justice, such as that which underpins the Marxian tradition, would tend to agree that the harm that results from rectification of past injustice is unimpeachable (Nozick 1974). Both libertarianism and Marxism essentially apply a justice-inscribed filter in assessing which harms are and are not normatively indictable (though they certainly define justice differently). In contrast, welfarist consequentialism would be more ambivalent about reparations—they, too, would have to be judged exclusively by their consequences.

A second type of example raises similarly difficult questions. A competitor in a game who “willingly” accepts the terms of the game has no recourse if she loses, provided the game was fairly structured and played.<sup>11</sup> Coming in second in a fair competition does not raise to the level of an indictable offense—either on the part of the winning competitor or of the officials. But what if the game is unfair, such that it yields a significant advantage to one competitor over the others; or if one is essentially forced to play a game that is rigged in some way or other? In this case, there is a basis for indictment—and for recognizing as ethically salient the harm suffered by the losers.

The matter of “fairness” in economic arrangements (and competition) is too easily dismissed by an economics profession that has demonstrated a tendency to privilege normatively negative over positive freedom. Economists in the tradition of Friedman and Hayek tend to argue that the bargains struck by two economic agents are ethically unimpeachable provided that the agents are equally free from interference by the state in pursuing their interests, and provided neither agent enjoys a monopoly. Far from yielding harm, any such bargain must be taken to represent an improvement in the respective positions of the two agents. This is true even if it appears to be the case that the gains that accrue to one agent from the bargain outweigh the gains to the other. Indeed, even where one agent enjoys monopoly power, the conclusion of a bargain between the two agents indicates that both parties benefit therefrom—though the position of the agent who does not enjoy monopoly power would be improved were the monopoly to be dismantled. For many economists it is axiomatic that where agents enjoy negative freedom, they are to be held accountable for the results of their respective decisions—and any harm they suffer

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<sup>11</sup> This begs the question what is “willing acceptance”? It is not enough to say, as Friedman tends to do, that volition requires only the absence of coercion, unless one is prepared to offer a full and nuanced account of coercion.



as a consequence of the bargains they reach or the risks they take are not ethically salient. Hence, the economics profession need not and indeed should not concern itself with attending to these kinds of harms.

This reasoning lets the economics profession off the hook far too easily, however. Economists sometimes engage in institutional design—and very often teach about institutional design to audiences that include those who will someday participate in that activity. In so doing, the profession influences the rules of the game that economic actors will perforce be compelled to play. Economists can advocate for economic institutions that promote very high payoffs, but at a relatively high risk of failure; or for arrangements that may not promise such high rewards, but that entail much lower risk. Alternatively, they can advocate for institutions that reward the winners and punish the losers heavily, at any given level of societal risk, or they can advocate for institutions where the gap between rewards and punishments are much less substantial. Once established, economic actors in the economy will have no effective choice but to play the game as determined by the institutional apparatuses of the economy. And so the choice of institutions establishes for the agents who populate an economy the range and extent of risks and rewards, on the one hand, and distribution of rewards and harms (at any given level of risk), on the other.

If we take seriously the role of the economics profession (including the theory it advocates) in influencing the choice of economic institutions, then we might be led to conclude that the profession bears some responsibility for at least some of the harms that are experienced by economic agents who operate on the basis of those institutions. This is not to say that each and every experienced harm should lead to civil litigation against the economics profession (though perhaps some should?), but that at a minimum the proliferation of harms ought to lead to serious critical self-reflection by individual economists and the profession as a whole about how its practice has induced misfortune. In short, and to conclude this thought, a profession that took serious account of its ethical duties would be much more attentive than ours now is to the harms that arise in consequence of the operation of the economic system. It would be far more inclined to ask how economic arrangements might be revised so as to reduce the incidence of harm, especially when those harms are severe, persistent and when they afflict those who are least able to bear it.

*3. Is there sufficient tacit acceptance of a system that generates harm as a normal facet of social advancement?*

This question returns us to Kaldor Hicks on the one hand, and Nozick on the other. There is a strong case to be made for potential as opposed to actual compensation under Kaldor-Hicks—it is that we all benefit, each of us, by living in a social arrangement that encourages social innovation, even if each of those innovations might in fact harm some of us. The idea here is that we are all the ultimate beneficiaries of an innovation-inducing arrangement; hence, the harm that falls on any one of us from any particular innovation is not ethically troubling. This in a sense was Hicks' view (1939). This view presumes tacit approval of an arrangement that will necessarily harm members—not for the greater good

of the greater number, but ultimately for the good of all. Its justification on grounds of fairness also presumes that the harms associated with successive innovations are independent. Today's winners are just as likely as today's losers to be tomorrow's losers, and vice versa. In this (special) case, each of us is a winner if the system on balance produces more socially beneficial innovations than alternative systems that are less risky but that generate less social innovation. And since we are all winners, there is a reasonable basis for inferring hypothetical or tacit if not actual consent of all of us to the arrangement.

Those of us on the left, on the one hand, and libertarians on the other, may not like the tenor or implications of this argument—but I'd suggest that it is one that we need to take seriously. It is in fact the implicit ethical justification for the widespread use of Kaldor-Hicks even in face of overwhelming evidence that losers from policy changes are rarely fully compensated for their losses. It is a claim that each of us has implicitly accepted a social arrangement that generates harm-inducing innovation, in order to secure its fruits, and so we are not warranted in demanding compensation for our misfortunes when we find ourselves temporarily in the role of loser. That would amount to double-dipping, as it were (and would also induce moral hazard problems). Nor are we ethically warranted in attempting to block any particular efficiency-inducing innovation that harms us.

Several objections can and should be offered to this argument, of course. The most obvious, from a political economy perspective, is that the incidence of gains and losses is not at all random. Being a loser today is correlated with having been a loser yesterday, and with being a loser yet again tomorrow. This likelihood follows from the fact that those with the greatest economic and political power are often in position to secure policy innovations that reflect their own, particular and immediate interests. This is not to deny that even the losers may secure some benefits from harm-inducing innovations. Workers who lose their jobs owing to the shift to a free trade regime may secure the benefit of lower consumer prices, for instance. It is to claim that there is something indictable about a system that concentrates harms among some for the ultimate benefit of others. This is true even if the losers come to take great pleasure in the relatively minor net gains that accrue to them over time—even if they are satisfied with the crumbs that fall from the banquet table (Sen 1992).

Libertarians have other grounds for concern about a framework for judging economic innovations in pursuit of economic advancement that may cause harm. For them, there is an ethically salient distinction to be drawn between those social innovations that occur without violating anyone's rights, and those that occur as a consequence of the use of the state's coercive powers and that violate some persons' rights. The work of Robert Nozick (1974) is relevant in this regard. Nozick's libertarianism is founded upon a side-constraint view of rights, which holds that one may not violate the rights of another in order to achieve what one takes to be a higher order social goal (such as economic efficiency). Indeed, one may not violate another's rights even if one is intending to minimize rights violations in the aggregate. Rights are taken instead largely to be inviolable constraints on how we act toward each other, and on how the institutions we create (such as the state) treat each of society's members.

From the libertarian perspective, actions by the state that are intended to promote Kaldor-Hicks efficiency but that entail the violation of some persons' rights are ethically indictable, despite their beneficial economic consequences. One notable example is the takings associated with eminent domain. Harm appears here not so much in the form of a loss of income or wealth, which may or may not be considerable, but in the deeper sense of rights violations (which may or may not cause a loss of income). In libertarian thought rights violations of this sort cannot be offset with *potential* compensation, or even with the promise of the higher net income in the long run that occurs as a consequence of a series of similar innovations. Nor can they be justified with a claim of potential or tacit acceptance of the regime that routinely violates rights. From this perspective, there must be an explicit agreement among each of society's members to live under an arrangement that distributes harms and benefits without attention in each case to rights; or, failing that unanimity, each policy innovation must be probed to ensure that it does not violate anyone's rights. Only an actual bargain between an economic actor and the state (where, for instance, the agent willingly agrees to sell property to the state) resolves this problem, since in that case there is no rights violation. Short of that kind of explicit bargain, policy innovation that achieves Kaldor-Hicks efficiency may very well entail substantial harm of a sort that Kaldor-Hicks cannot begin to theorize properly, validate, or compensate.<sup>12</sup>

## Conclusion

The foregoing represents the barest of beginnings of the kind of exploration of economic harm that is required of a profession that seeks to face up to its ethical responsibilities. Economists have chosen for too long to avoid the complex nature of harm in the abstract, and economic harm in particular. In this the founding assumptions of neoclassical theory have served as enablers. Neoclassical theory presumes an inadequate account of human nature that entails a view of rationality which obscures the diverse ways that agents can be harmed. Human rationality is taken to imply *inter alia* the commensurability of all benefits and harms on the one hand; and the exogeneity of preferences on the other. The former allows for a simplistic calculus of harm which takes the economist off the hook for many of the harms his interventions might induce. The Kaldor-Hicks compensation test provides immense service in this regard. Relatedly, the exogeneity of preferences allows the economist to suppress the otherwise obvious insight that participation in the economy, economic flows and outcomes, and the related structure of our economic institutions all participate in the constitution of not just our preferences, but even our deepest subjectivity and identity. This allows the economist to take comfort in the Kaldor-Hicks compensation calculations, since the agent is taken as sufficient guide to the harm s/he suffers as a consequence of an economic intervention.

Rejecting the rationality assumption and the welfare consequentialist normative framework of neoclassical theory, then, opens up a wide terrain of inquiry into the nature of harm, and the harms associated with economic interventions. The terrain comprises both positive and normative questions, and their necessary interdependence. The prospect

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<sup>12</sup>For an examination of Austrian objections to Kaldor-Hicks see Stringham (2001).

of this new field is not just exciting, though it is that, too. It is also imperative. A profession that is in the harm business—routinely generating substantial harm as a normal byproduct of its efforts to promote the social good—has a deep, inescapable obligation to examine the nature of that harm, and the ethical burdens that attend it.

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