This is the fifth of a series examining the moral dimensions of economic "externalities", the spillover or incidental side effects in market activity.

The series is available in expanded form, with an introductory chapter and updated essays, as an e-book to facilitate reading and annotating: https://nmichaelbrennen.com/shop/.

Daniel Hausman, an analytic philosopher of economics, added a dimension to externality studies with a paper that considered spillovers as problems of justice, not merely as inefficient disequilibria. Hausman's definition sounds similar to one an economist might use: "an unintended and not fully voluntary effect of some agent's actions on others" (§1.) However, as a philosopher he focuses on its ethical aspects: "what is crucial about spillovers from the perspective of justice is that A's actions have effects on individuals besides those engaged in any voluntary transaction with A" (§1). Non-voluntary spillovers may be positive/beneficial or negative/harmful; they may be pecuniary/monetary or non-pecuniary/non-monetary.

Hausman approached the question of spillovers more generally than an economist might; given that any action may have a non-voluntary result on another, "externalities are unavoidable and ubiquitous" (§.) He illustrated this by his buying the last six pack of beer at a convenience store; as an unintended consequence of his action, the next customer "may be made miserable or saved from alcoholism" (§1.) From an economics view of efficiency, outcomes may be suboptimal; were the parties able to negotiate, the next customer might want the beer more and be willing to compensate Hausman for it. Where economics generally considers unintended spillover effects as incidental in the whole system of voluntary exchanges that make up the economy, for Hausman externalities are not "minor complications, exceptions, or qualifications. This whole image of market life and social justice is hopelessly distorted" (§2.)

Regarding welfare economics, Hausman pointed out that for most economists, externalities arise because only because there are transaction costs, not from the externality itself. By reducing transaction costs, situations are closer to optimal, externalities cease to be a normative concern. The only moral problems remaining are distributional, and those can addressed by adjusting property rights or transfer payments, not by interfering in market operations (§5.) This is insufficient for Hausman; arguing from a consequentialist view, there are times when "the consequences of externalities can be so grave or wonderful that they must perforce be morally significant," but moral intuitions are inconsistent in how people evaluate that significance (§5.) Though Hausman did not reference Schumpeter's term "creative destruction," the examples he cited of externalities causing real hardship were those due to market changes and not the consequence of misconduct or incompetence.

Elsewhere he argued that the "harms and benefits associated with externalities are of prima facie moral significance;" given the nature of the transaction costs involved, "frictional problems caused by externalities are best handled (if at all) by standard welfare-state policies" (§6.) As a consequentialist, he argued that the critical factors determining when to intervene are the consequences of arranging the compensation; he acknowledged that there are spillover effects due to State intervention, but given the "great suffering" that some economic shifts can cause, he concluded by arguing for "welfare-state policies of high employment, generous unemployment insurance insurance, and good job retraining programs" (§5) rather than attempting case by case

compensation.

As a brief aside, a long-standing objection to welfare economics interventions as advocated by Hausman are their interference in the price system. Prices play a crucial role in communicating information about relative supply and demand, and are thus a key factor in allocating resources. When supply and/or demand change, prices rise or fall, and market agents respond by altering production or consumption, or finding substitutes; price functions as a cheap and effective communication system (Hayek, 1945.) A central objection to market interventions to correct perceived imbalances is that such interventions artificially alter prices, which alters the dynamic allocation of scarce goods, which can create overages or shortages.

To this point Hausman's argument is within the bounds of welfare economics, though with a moral dimension not normally considered by welfare economists; however, he has a deeper concern, and an extended quote seems warranted to express his concern.

> The real problem with all the above moral perspectives lies in the vision of market life (and perhaps even social life as a whole) as nothing but the means by which individuals pursue their own objectives. For through market life we collectively shape human existence. We not only make expensive, difficult, or impossible the satisfaction of some given preferences (and cheap, easy, or inevitable the satisfaction of others,) but over time we remake our own and our children's and grandchildren's preferences. … What is needed is a view of market processes that sees voluntary exchange among individuals as an integral part of a series of complex social linkages. (§6)

He followed with examples of externalities in Public Choice sorts of market exchanges in American political life and the encroachment of blood donation markets in the place of "altruism and solidarity;" in this Hausman seems to share some of Michael Sandel's concerns of markets undermining communitarian values. The standard view sees markets as voluntary exchanges, and externalities are exceptions; for Hausman "Externalities are the normal case. Pure voluntary exchanges without spillovers are the exception" (§6.) Focusing on externalities in terms of efficiency, rather than rights violations, welfare economics obscures questions of justice, and in so doing may miss crucial unseen large scale social spillovers in market exchanges. Hausman concluded that when "Jack and Jill make a deal, we all may come tumbling after; and I'd rather know what is coming and have a voice in some of their machinations than pretend that only their interests are at stake in their deals" (§6.)

Though the concluding section in which Hausman opened his argument to wider themes is quite brief, it seems clear that Hausman did not trust the spontaneous, emergent order of markets to dynamically address problems as they arise. He did not develop how he might address such large scale spillovers, but it seems consistent with his welfare state stance to expect that he would look to some sort of State intervention.

Considering just one scenario that might fit Hausman's concerns, in a podcast interview on Econtalk the economist Tyler Cowen projected a future in which low skill labor will be

increasingly displaced by technological advances, and work will increasingly shift upward into fewer and fewer high skill jobs to support the new technologies. His is not an optimistic picture of the future. If Cowen is correct, one spillover effect of technological development may be to increase the size of the labor force at the bottom, putting downward pressure on wages for that group. It seems consistent with Hausman's consequentialist concern that such an outcome would raise significant moral questions, questions that go well beyond standard welfare economic intervention.

It seems to me that Hausman's deeper concern raises meta-questions about markets that go well beyond welfare economics. Interfering with markets to affect expected long term shifts – such as those anticipated by Cowen – fundamentally conflicts with a long tradition in economic thought, from the Scottish Enlightenment on, that understands markets as a spontaneous, bottom-up, emergent order, rather than a planned top-down order. In 1767, Adam Ferguson expressed that social order in general, including markets, is "the result of human action, but not the execution of any human design" (see *Spontaneous Order*; see also my blog post on Jean-Pierre Dupuy) As Hayek consistently pointed out, attempts to plan the sorts of structural interventions required in order to achieve desired market outcomes comes up squarely against the limits of knowledge of the planners. Hayek summed it this way: "Human reason can neither predict nor deliberately shape its own future. Its advances consist in finding out where it has been wrong" (1960.) While one might reasonably discuss the limits of Hayek's argument, particularly in small scale projects, the larger the scope of planning the more I think Hayek's argument must be given consideration.

I have some sympathy with Hausman's deeper concerns; however, serious questions remain open about how Hausman might implement his deeper concerns while avoiding the problems that Hayek and others have long argued and avoiding even more serious moral spillovers.

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