

Kaldor-Hicks Improvement and Justice: To the Discussion on Normative Economics

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Abstract

The author's main objective is to point out the existence of the paradox of involuntary improvement and to present a solution to this paradox. The paradox of involuntary improvement appears when a subject which suffers an injustice involuntarily still gets better off by this change. The suggested solution consists in the decomposition of the total effect of the pseudo-contract into the effect of the basic contract (which is desirable for the subject) and the effect of the super-contract (which is undesirable for the subject). Such a decomposition is not arbitrary, in the author's view, but necessary because it reflects the self-contradictory nature of the pseudo-contract, such as usury and sale/purchase at an unjust price. The author argues that the contract of usury and sale/purchase at an unjust price do not represent cases of Pareto improvement but rather cases of Kaldor-Hicks improvement (Kaldor, 1939; Hicks, 1939). The author's complementary objective is to show that the positive – normative dichotomy is an artificially created distinction which is supposed to cut off economics from its mother discipline, philosophy, and which moral sceptics used to deprive moral philosophy of the status of science.

Keywords: Kaldor-Hicks improvement, Pareto improvement, normative economics, equality in exchange, usury, just price

JEL Classification: A12, B41, D61, D63

1. Introduction

It would be complicated to find a concept which represents a stronger argument in favour of the ideology of laissez-faire than the concept of Pareto efficiency. It is an ingenious move by the advocates of laissez-faire. The concept is strictly speaking value-free – to use the positivist vocabulary – which is why you cannot call an argument normative, which hinges on the Pareto efficiency. Indeed, if a situation is Pareto-inefficient, this can provoke negative emotions in the listener but this fact does not in itself imply whether such a situation is objectively good or objectively bad. A Pareto-inefficient state is simply a state when at least one subject can get better off (in terms of subjective utility) without anyone else getting worse off. If at least one subject can get better off without making anyone else worse off (or while someone else gets better off, too), then, such a situation is called Pareto-inefficient (or Pareto-suboptimal). This statement does not imply that the subject in question “should” get better off, neither does it imply that it is objectively wrong when someone prevents them from getting better off. Economics, says the positivist, is unable to pass such a judgement. The maximum an economist can say – as long as he speaks in his capacity of an economist – is that such a situation is not Pareto-efficient. The statement that it is wrong to prevent someone from getting better off, as long as no one else gets worse off, is normative. Now, since “normative” equals – according to so many economists – unscientific, it is logical why this kind of economists draws such a clear division line between talking “as an economist” and talking “as a (mere) philosopher.”

Why have I said that introduction of the concept of Pareto efficiency is an ingenious move by the laissez-faire advocates? Well, because everyone who adheres to the basic imperative of laissez-faire “live and let live” will draw the normative conclusion from a value-free premise that a situation is Pareto-inefficient. May everybody draw the conclusion for himself, as if the laissez-faire advocates were saying. We just say that a situation is Pareto-inefficient. The discrediting act of an inference of the normative conclusion is unnecessary to the economist. May everyone do this act “privately” as a philosopher. Of course, it is an unprecedented hypocrisy. However, this tactic is extremely effective (cf. Fleurbaey, 2004, pp. 134–135).

Since it is always possible to extend the set of subjects of a change (e.g., an exchange or a transfer) in such a way that at least one subject will be worse off as a result of this change, it can be argued that any state is Pareto-efficient from the viewpoint of the community or society, which means that no Pareto improvement will ever be achievable. The concept of Kaldor-Hicks improvement is a reaction to this objection and what Blaug (2007, p. 186) calls *the centerpiece of “the new welfare economics”*. A certain change represents Kaldor-Hicks improvement if at least one subject can get better off without making anyone else worse off (Pareto improvement) or if at least one subject can get better off and is able to compensate those which got worse off as a result of the change.

Kaldor describes the concept as follows:

“There is no need for the economist to prove – as indeed he never could prove – that as a result of the adoption of a certain measure nobody in the community is going to suffer. In order to establish his case, it is quite sufficient for him to show that even if all those who suffer as a result are fully compensated for their loss, the rest of the community will still be better off than before. Whether the landlords, in the free-trade case, should in fact be given compensation or not, is a political question on which the economist, qua economist, could hardly pronounce an opinion” (Kaldor, 1939, p. 550). Whether such a compensation should or should not be paid, Kaldor regards as a normative question which is beyond the borderline of positive economics. Similarly, Hicks says: *“I do not contend that there is any ground for saying that compensation ought always to be given [...] This being so, it will often happen in some particular case that the economist will find himself not at all anxious for compensation to be given; but his personal feeling in that direction will be based either upon the non-economic ground that the persons damaged do not deserve much consideration, or upon the only quasi-economic ground that the loss inflicted on them is nothing but the materialisation of a risk they may be expected to have allowed for”* (Hicks, 1939, pp. 711–712).

A whole lot of objections have been raised against the concept of Kaldor-Hicks improvement (for an overview, see, e.g., Bostani and Malekpoor, 2012). One of them is the objection saying why should a subject whom the change made better off want to compensate another subject whom the change made worse off (van Staveren, 2009, p. 110). I will answer this objection later in this paper. Kaldor-Hicks compensation (or the Second Fundamental Theorem of Welfare Economics) is usually discussed (and criticized) in the context of welfare improvements achieved by means of public redistribution of wealth via taxation and transfers. In this context, Mark Blaug says: *“Virtually all writers on welfare economics, and certainly all applied economists, dismiss the second theorem as being of limited practical relevance because a lump-sum tax is a personal liability that no action by the taxpayer can alter, while a lump-sum bounty is equivalent to an adjustment of initial endowments; thus, a lump-sum transfer of income or wealth must be based on individuals’ personal characteristics that are either directly observable by a fiscal authority or that individuals have an incentive truthfully to reveal to that authority, neither of which conditions is ever likely to be met”* (Blaug, 2007, p. 197). Objections of the same nature have been raised by Stringham (2001) and DeMartino (2015). I do not think this objection is relevant against the concept as applied in this paper because in this paper, I do not apply the concept of Kaldor-Hicks compensation to support the possibility of welfare improvement by a third-party intervention but to explain why a private contract can improve the welfare to both parties of the contract even if the condition of mutual voluntariness is violated. An objection to the Kaldor-Hicks improvement which seems to be more relevant to the concept as applied in this paper was raised by David Ellerman (2008), who gave a proof for his statement that the efficiency requires that the compensation really is given: *“The Kaldor-Hicks principle (potential Pareto improvement) has fostered the modern*

revival of an older Marshall-Pigou tradition of welfare economics. [...] By characterizing an increase in the size of the pie (i.e., a Kaldor-Hicks improvement) as an “increase in efficiency, this modernized Marshall-Pigou-Kaldor-Hicks (MPKH) tradition seeks to transcend the strictures of the Paretian treatment of efficiency (which would require actual compensation of the losers so that the whole change was a Pareto improvement)” (Ellerman, 2008, p. 1). “The Kaldor-Hicks argument that efficiency does not require the numeraire transfers is only numeraire illusion” (Ellerman, 2008, p. 21). In other words, without the corresponding compensation, the transfer does not increase the allocative efficiency, either potentially, or actually. Nevertheless, I do not think this objection is relevant against the concept as applied in this paper, either. In this paper, in fact, I assume that the compensation is always given. Yes, the Kaldor-Hicks improvement where the compensation is actual, not only potential, should be termed differently. Maybe Kaldor-Hicks-Ellerman improvement? For the central argument of this paper, Ellerman’s objection is not relevant, though.

In the section “Methodological Reflection”, I will try to supply an explanation to why I consider the normative – positive distinction unnecessary and misleading. In the section “Equality in Exchange”, I will present the concept of the exchange equality and its most important applications: usury and just price. In the section “Paradox of Involuntary Improvement”, I will put forward the central problem of this paper and its suggested solution. In the section “Usury as Kaldor-Hicks Improvement”, I will demonstrate the paradox of involuntary improvement and its solution by the example of the usurious contract. Analogously, in the section “Purchase at Unjust Price as Kaldor-Hicks Improvement”, I will demonstrate the paradox of involuntary improvement and its solution by the example of the unjust price. In the section “Summary and Conclusion”, the key arguments of this paper will be summarized.

2. Methodological Reflection

The purpose of this chapter is to rehabilitate the position of philosophy (moral philosophy, chiefly) in the hierarchy of sciences and, by means of this rehabilitation, to justify and rationalize why a topic from moral philosophy is relevant for economics. The complementary purpose of this chapter is to set the discussion about non-equal “exchange” into the broader context of the discussion with a laissez-faire opponent who makes use of the concept of inefficiency in order to avoid drawing normative conclusions because, in his eyes, such conclusions would be “mere philosophy”.

I will argue that the categorization of scientific disciplines with respect to the distinction into positive – normative is somewhat misleading (Máslo, 2021, pp. 31–34). First of all, this categorization is based on a wrong (because self-contradictory) thesis that normative judgements are necessarily subjective and, in effect, unscientific because they are not empirically testable (Friedman, 1953, pp. 147–148; cf. Robbins, 1932, p. 123). The proof by contradiction is obvious: the thesis itself is not empirically testable which means it is, in effect, subjective. What is

subjective is not objectively valid. However, the speaker asserts his thesis with a claim to its objective validity because, otherwise, he would be passing a judgment such as “*I like this coffee.*” Next, some elder economists such as John Neville Keynes (1890), who had not sunk into their noetic followers’ moral scepticism yet, still insisted on the necessity to separate normative economic research from positive economic research. The reasons given by them are more or less speculative, though, not apodictically convincing. For example, the separation of the normative from the positive economic research is allegedly more practical with respect to the goals of both research programmes because “*we may be sure that the more its principles [of political economy] are discussed independently of ethical and practical considerations, the sooner will the science emerge from the controversial stage*” (Keynes, 1890, p. 28). Well, if we compare the list of schools of economic thought which existed in the times of Keynes Senior with the list of schools existing today, I do not think the reasons presented by him are too convincing.¹

Above all, though, the very dichotomy of positive – negative omits completely the possibility that the so-called normative judgements can be expressed purely positively. Instead of the statement “*It is wrong to rob other people,*” we may simply say: “*To rob other people is a violation of the objective moral law.*” It is not about how we formulate it, of course. It is about what the particular formulation stands for. If someone rejects the existence of the moral law, independent of a man’s will, then, it is logical that all judgements such as: “*This is good*” and: “*This is wrong*” are considered by him purely subjective (“*I consider this thing good/wrong.*”) or conventional, at best (“*We have agreed that we will consider this thing good/wrong.*”). However, if it held true that: “*This thing is objectively good*” – or: “*This thing is objectively wrong*”, then there is no point in separating the judgements into positive and normative.

Positivists such as the above mentioned Milton Friedman are modern epigones of empiricists of the modern age such as John Locke and David Hume, who, as the first thinkers of the modern age, coined the idea that only the sensory experience mediates objective knowledge of the reality to us, an idea which Fuchs (2015, p. 181 ff) calls the empiricist dogma. In effect, this version of empiricism results in a conclusion about the impossibility of science, though. In fact, science formulates general and necessary judgements. However, the senses mediate information about

1 Colander and Su (2015) reject the interpretation according to which Robbins (or Keynes Sr.) were positivists because “[F]or logical positivists, ethics is non-cognitive and meaningless” (p. 161), while ethics was neither non-cognitive, nor meaningless to Robbins (or Keynes, Sr.), according to Colander and Su (2015, p. 5). What I say is neither that Keynes Sr. or Robbins were positivists nor that they would not regard ethics important. I just say that, according to both Keynes Sr. and Robbins, it is necessary to separate normative economic research from positive economic research because normative judgements are necessarily subjective and, in effect, unscientific because they are not empirically testable. Colander and Su claim: “*For Robbins, **ethics** is crucial to economic policy analysis, but however important, it is **not science**. This position is consistent with Mill’s science-art distinction and Keynes’s tripartite division of economics and this is why we see Robbins in the Mill–Keynes tradition*” (Colander and Su, 2015, p. 162). Which, I think, confirms my position.

accidental characteristics of beings to us. General concepts are the product of the reason. The reason, tough, cannot mediate objective knowledge of the extramental reality to us, according to Locke's empiricist dogma. That is why Kant came up with the a priori forms as a solution which the majority of modern philosophical schools borrowed from him. It is by far not just the Austrian school of apriorism of Mises who adhered to apriorism intentionally (see Mises, 1949). It is Robbins and Friedman, too, who borrowed Kant's apriorism indirectly. According to apriorism, the human reason does not create general concepts via abstraction. According to apriorism, the general concepts exist in our reason as if "ready" or a priori. Where such a general concept (a priori form) does not have a *meaningful empirical counterpart*, such a general concept is not *useful in analysing a particular class of concrete problems*. (Friedman, 1953, p. 148) In other words, it is pure metaphysics. According to this logic, even the founder of apriorism Kant would be forced to liquidate the objective moral law because concepts such as "good" and "law" do not have a *meaningful empirical counterpart* because such concepts capture the necessary determinations of so-called rational beings, *i.e.*, beings which do not exist outside of reason. That is why Kant resorted to dogmatism (Fuchs, 2020, p. 54 ff). Modern economists do not have such scruples anymore. Ethics or moral philosophy is not "hard science" to them, which means it is not science at all, actually.

To rule out a possible misunderstanding: I do not say that economics should produce normative judgments. What I say is just that the dichotomy of positive – normative is an artificially created distinction which (1) is supposed to cut off economics from its mother discipline, philosophy (such as economics was understood by Adam Smith and, paradoxically enough, by John Neville Keynes himself); and which (2) moral sceptics used to deprive moral philosophy (and metaphysics in general) of the status of science and to banish it into the field of "mere philosophy" (as Friedman does when he philosophizes about economics and, doing so, he contradicts himself hopelessly). If the concept of justice were perceived as having an objective content, then the anxious care of the "positive" character of economics and the zealous crowding out of all, even concealed "normative" statements would be pointless. The question of usury and just price, which I am going to treat later on in this paper, would simply be one of those interdisciplinary problems which we can only be addressed using apparatuses of both mentioned disciplines, economics and philosophy.

Milton Friedman (1953, p. 146) says: "*Positive economics is in principle independent of any particular ethical position or normative judgments. [...] Normative economics [...] on the other hand, cannot be independent of positive economics.*" No one smaller than Keynes Senior himself disproves Friedman when he says: "*It is universally agreed that in economics the positive investigation of facts is not an end in itself, but it is to be used as the basis of a practical enquiry, in which ethical considerations are allowed their due weight*" (Keynes, 1890, p. 26). In other words, economics should serve moral philosophy as an instrument. Let us add that the relation of economics and moral philosophy is not given arbitrarily by our

preferences but is given by the very goal on which the former or the latter discipline is focused. Philosophy is focused on the examination of necessary determinations of beings; moral philosophy, specifically, is focused on the examination of the necessary goal of the human life, which is just a correlative of the question: “What is a human necessarily?” Economics, on the other hand, is focused on examination of regularities in the human behaviour or the question: “What is a human on certain conditions?”

3. Equality in Exchange

The Aristotelian concept of equality in exchange remains misunderstood by the majority of economists. If a subject were supposed to gain a level of utility by the exchange as he gives up, such an exchange would be pointless. However, the concept of equality in exchange is not based on equality of subjective utilities but on equality of objective exchange values.

The problem of unequal exchange addressed by me in this paper is a part of a research programme which is based on the foundations of the Aristotelian-Thomistic philosophy and which is, unfortunately, still at the periphery of the focus of academic economists. It is an interdisciplinary programme at the intersection of economics, law and philosophy. The main proponents of this research programme are Professor James Gordley, Professor Brian McCall and Christopher Ferrara, who are treating the problem from the viewpoint of law and philosophy. Gordley opened the problem of unequal exchange with his seminal paper *Equality in Exchange* (Gordley, 1981). Since then he has been analysing this phenomenon as a part of his Aristotelian legal tradition in the theory of contract (*e.g.*, Gordley, 2001, p. 297 ff; 2006, p. 361 ff; 2011, pp. 97–101). McCall is mainly interested in the analysis of the usury as an example of unequal exchange from the perspective of the Thomistic philosophy and theology (*e.g.*, McCall, 2008; 2013, pp. 54–60). Ferrara deals with the problem of unequal exchange, both the unjust price and the usury, on the background of his argument with the *laissez-faire* ideology (Ferrara, 2010, pp. 140–159). On the opposite side of the argument, there is, *e.g.*, Alejandro Chafuen (2003, pp. 79–99, 119–127) who is (dis?) interpreting the Late Scholastics as an *avant-garde* of *laissez-faire*, free-market ideology. Máslo (2021, 2022a, 2022b) develops the problem of unequal exchange for the cases of unjust wage, unjust price and usury, respectively, by reacting to objections of the *laissez-faire*. While Máslo (2021, 2022a) treats the problem from the perspective of philosophy, Máslo (2022b) makes an effort to “translate” the concept of unequal exchange into the language of economics, and, in this way, open the philosophical-legal problem of unequal exchange to the economic academia. What I consider insufficient in the argumentation of Máslo (2022b), though, is the missing distinction between Pareto improvement and Kaldor-Hicks improvement. In this regard, I want to pick up on Máslo (2022b) in the process of “translation” of the phenomenon which I call here the paradox of involuntary

improvement from the philosophical language to the language of economics but, unlike Máslo (2022b), I am going to extend the scope of analysis to both usury and unjust price, which should help the conclusions reach a higher level of generality.

Contracts can be divided into two groups: so-called onerous contracts and so-called gratuitous contracts (Máslo, 2022a, p. 15; Gordley, 2011, p. 78). While the first type of contract is usually referred to as “exchange” in the economic community, the second type is usually referred to as “transfer” or “gift” (see Gordley, 2011, pp. 1, 49). This means that I can either exchange my property rights with someone, or I can assign my property rights to someone free of charge. It holds true, out of necessity, that if and to what extent I want to exchange my property rights with someone, then and to that extent I do not want to assign my property rights to that person free of charge at the same time. Vice versa, if and to what extent I want to assign my property rights to someone free of charge, then and to that extent I do not want to exchange my property rights with that person at the same time. As a result, if I give up an item or money of a certain market value and, at the same time, I do not want to give a transfer to the contractual counterpart, then I need to acquire an item or money of equal market value from the contractual counterpart.

The above implies that a “non-equal exchange” is a contradiction in terms. To what extent a contract is an exchange, to that extent this contract is necessarily equal. And vice versa, to what extent a contract is non-equal, to that extent it cannot be an exchange. “Non-equal exchange” is a *contradictio in adiecto*, simply, which is why an expression of consent to such a pseudo-contract does not mean anything but a meaningless sound (“blah blah blah”). A contract which suffers a contradiction of the will of at least one contractual party is defective and, in effect, invalid from the very beginning and, therefore, unenforceable. Apart from its self-contradictory nature, such a pseudo-contract can also be predicated a commutative injustice. Such a pseudo-contract suffers from a self-contradiction which means it is nothing, that is true, but the transfer which accompanies this pseudo-contract is not nothing but something real. Now, if this transfer is not given voluntarily, it is given involuntarily as a consequence, which means it violates commutative justice. There is a threefold cause of involuntariness: external direct coercion, external indirect coercion and deception (Máslo, 2022a, p. 20). The external indirect coercion of party B by party A consists in that the contractual party A offers his consent to the **basic contract**, to which the contractual party B has not right, in exchange for the consent of the contractual party B to an unrelated contract (**super-contract**). In the case of usury, the basic contract is the interest-free

loan contract (“100 now for 100 later”)² and the super-contract is the sale of the loan contract for the interest (“100 now for 100 later” in exchange for 10). In the case of unjust price, the basic contract is the equal sale contract (a good with the market value of 100 for 100) and the super-contract is the sale of the equal sale contract for a non-zero price (“a good with the market value of 100 for 100” in exchange for 10). Since by consenting to the super-contract the contractor A negates his consent to the basic contract, at the same time, the above-mentioned pseudo-contract (“non-equal exchange”) is a complex of two mutually contradicting contracts and, in effect, is self-contradictory. In the case of usury, if A consents to lend 100 for 100 to B and, at the same time, wants to “sell” his consent for 10, then A is negating his initial consent to the “100 for 100” loan contract because he wants to “exchange” 100 for 110. If A does not consent to the “100 for 100” loan contract, he cannot sell it for 10, though. If he cannot sell it for 10, for what does he charge the payment of 10? In the case of unjust price, if A consents to sell a good with a market value of 100 for 100 and, at the same time, wants to “sell” his consent for 10, then A is negating his initial consent to the “100 for 100” sale contract because he wants to “exchange” 100 for 110. In agreement with Máslo (2022b, p. 44), I use the distinction into basic contract – super-contract when I talk about the pseudo-contract of “non-equal exchange” from the subjective perspective, while the distinction into exchange – transfer will be used when the pseudo-contract of “non-equal exchange” is looked at from the objective perspective.

4. Paradox of Involuntary Improvement

There are cases of injustice in which one subject gets better off and another subject gets worse off at the same time. With respect to the impossibility of interpersonal comparison of subjective utilities, such situations are Pareto-ambiguous. In such situations, one subject is moving up onto a higher indifference curve and another is moving down onto a lower indifference curve. Economists who insist on a strict separation of normative and positive judgements are unable to say more about such a case. However, there are cases of injustice in which both the perpetrator

2 That I define the loan contract as the interest-free loan contract is not an arbitrary choice of mine. With respect to the above-mentioned distinction of exchange vs. transfer, the loan contract is an (equal) exchange. If the (equal) exchange should consist in an exchange of a loan (100) for a principal (100) plus interest (10), then, the interest would have to be a compensation for something that the creditor assigns to the borrower on top of the loan, *e.g.*, the loan period, liquidity, creditor’s consent *etc.* For a detailed proof of why these items cannot be exchanged for the interest – and, as a result, why the loan contract has to be an interest-free loan contract – see, *e.g.*, Máslo (2022b, pp. 34–35). In a nutshell, the loan period belongs to the essence of the loan. Selling it is tantamount to selling the consent to the loan itself, which is a contradiction. The liquidity is always assigned to the borrower for a certain loan period, without which the liquidity would be of no use to the borrower. The loan period belongs to the essence of the loan, though. Ergo, as to selling the creditor’s consent, the proof by contradiction is given above.

of the injustice and the victim get better off. Such a situation represents a Pareto improvement, seemingly. How can a suffered injustice shift the subject up onto a higher indifference curve, though? If a subject suffers the injustice involuntarily, then he gets worse off and moves down onto a lower indifference curve. If a subject suffers the injustice voluntarily, then, as a matter of fact, the action of the counterpart does not have any influence on the subject's decision. For example, someone robs me but I would have given the stolen sum of money to him anyway. The subject gets better off in spite of the suffered injustice because this injustice is suffered voluntarily. However, there are cases of injustice suffered involuntarily in which both the perpetrator of the injustice and the victim get better off. This is a paradox, though. In fact, a shift onto a higher indifference curve is voluntary, by definition. And vice versa, involuntary action shifts the subject down onto a lower indifference curve, by definition. So, if we say that a subject moves up onto a higher indifference curve as a result of an involuntary action, it is an obvious contradiction.

I see the solution in the decomposition of the total effect of the pseudo-contract into the effect of the **basic contract** and the effect of the **super-contract**. While the subject moves up onto a higher indifference curve as a result of the basic contract, he moves down onto a lower indifference curve as a result of the super-contract. Now, since the effect of the basic contract prevails over the effect of the super-contract, the subject moves up onto a higher indifference curve at the end of the day. The situation of the other subject is the same. This is not a Pareto improvement, though, but – as I contend – a Kaldor-Hicks improvement. In fact, the subject is more than compensated for decreased utility as a result of the indirectly enforced super-contract by increased utility as a result of his consent to the basic contract.

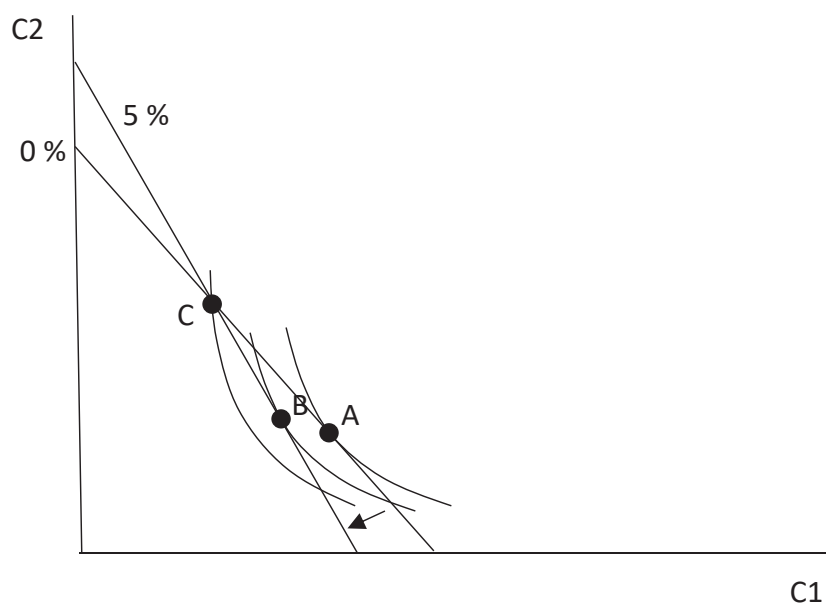
That a subject could get onto a higher indifference curve through an involuntary act seems to be contradiction in terms, really. However, the philosophical-legal argument is unambiguous: the contractual party of an unequal “exchange” does not want to give a transfer but he gives a transfer, ergo: he suffers an injustice involuntarily. At the same time, though, the economic argument is also unambiguous: the contractual party of an unequal “exchange” is getting better off, ergo: he moves onto a higher indifference curve. Now, the only thing we need to do is to find a way to demonstrate this situation in a model of indifference analysis. The solution seems to be to decompose the total effect of the unequal “exchange” (pseudo-contract) into the exchange and the transfer. The shift onto a higher indifference curve of one contractual party of an unequal “exchange” is always “redeemed” by a simultaneous shift onto a lower indifference curve, where the upward shift prevails over the downward shift. That is why we can say that, at the end of the day, the subject is better off.

The objection of van Staveren (2009, p. 110) against the concept of Kaldor-Hicks improvement says: why should a subject who gets better off want to compensate a subject who gets worse off? I assert that this paper gives an answer to this objection: a subject who gets better off as a result of a certain change will compensate the counterpart because the counterpart forces him to do so.

In fact, the counterpart places the compensation as a condition of his consent to this change; *e.g.*, the borrower compensates the lender by the usurious interest in exchange for the lender's consent to the interest-free loan. At the same time, though, the lender compensates the borrower by the interest-free loan in exchange for the borrower's consent to give a transfer (usurious interest) to the lender. That is why the external indirect coercion is reciprocal in the usurious contract, although only the lender commits an injustice with respect to the borrower because the borrower gives a transfer to the lender to which the lender has no right (Máslo, 2022b, p. 39).

5. Usury as Kaldor-Hicks Improvement

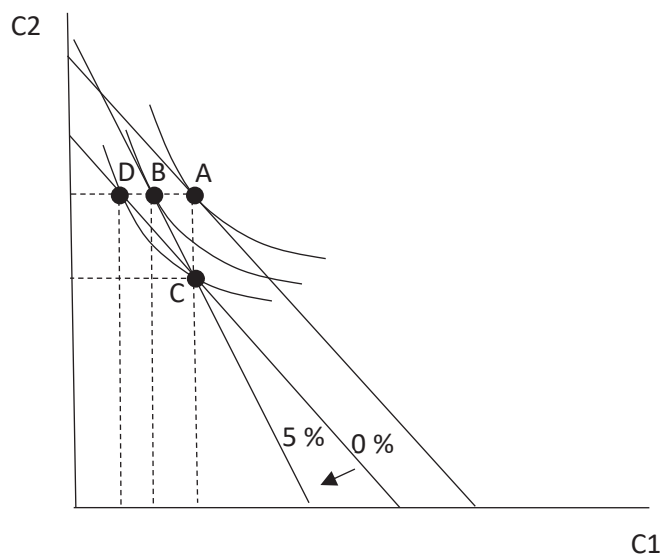
Equality in exchange concerns two types of contracts: a loan and a sale/purchase. As a result, equality in exchange is a central concept for the analysis of two kinds of phenomena: the usury and the just price. For a detailed treatise on equality in exchange and usury, see, *e.g.*, Máslo (2022b). In a nutshell, if the lender charges the borrower an interest on top of the principal – provided that this interest cannot lean on any existing extrinsic title, *i.e.*, it is a usurious interest – then such a contract of loan violates equality in exchange. Violation of equality in exchange is an act of commutative injustice, *i.e.*, injustice consisting in one person depriving another person of that to which the other person has a right. Thus, usury means that the lender offers his consent to an (interest-free) loan (which is the basic contract from the borrower's perspective) in exchange for the borrower's consent to pay an interest, *i.e.*, a transfer (which is the super-contract from the borrower's viewpoint). Alternatively, usury means that the borrower offers his consent to pay an interest, *i.e.*, a transfer (which is the basic contract from the lender's perspective) in exchange for the lender's consent to provide the borrower a loan (which is the super-contract from the lender's viewpoint). There is a contradiction in the lender's will, in effect, which is why such a pseudo-contract is not legally enforceable under any circumstances. As Máslo (2022b, p. 35 ff) shows, the contradiction is present in the borrower's will, too. At the same time, the transfer is indirectly enforced by the lender, who has no right to the transfer, which is why this pseudo-contract violates commutative justice. However, the borrower gets better off as a result of this pseudo-contract, no matter how contradictory and unjust it is, because the usurious loan is still more preferable to the borrower than no loan. Is it a Pareto improvement, then? A partial solution is suggested by Máslo (2022b, p. 41 ff). The borrower who takes a usurious loan gets worse off as a result of the payment of the usurious interest but he is compensated by the lender for this deterioration in the form of the interest-free loan. In addition to Máslo (2022b), I say that this change is not a Pareto improvement but a Kaldor-Hicks improvement. The reason is that the usurious loan is not a contract of exchange but a complex of a contract of exchange and a contract of transfer, where the borrower gets worse off as a result of the transfer but gets better off as a result of the exchange. The borrower will get the lender's consent to the exchange (interest-free loan) – the Kaldor-Hicks compensation – only in exchange for the transfer (interest payment).

Figure 1: Effects of usurious pseudo-contract on borrower

Source: Máslo (2022b, p. 41)

In Figure 1, the borrower's situation within a usurious pseudo-contract is captured. Point C means that the borrower stays in his endowment point, *i.e.*, without a loan. Point A represents a combination of the borrower's present and future consumption if he achieved an interest-free loan. Point B represents a combination of the borrower's present and future consumption if he took a loan for 5% interest. It holds true that $U(C) < U(B) < U(A)$. The usurious pseudo-contract offers to the borrower that he can move from C to B. However, since the usurious pseudo-contract can be decomposed into the basic contract (interest-free loan) and the super-contract (sale of the interest-free loan for 5% interest payment), the borrower faces an offer to move from C to A (basic contract) in exchange for a subsequent back-shift from A to B (super-contract).

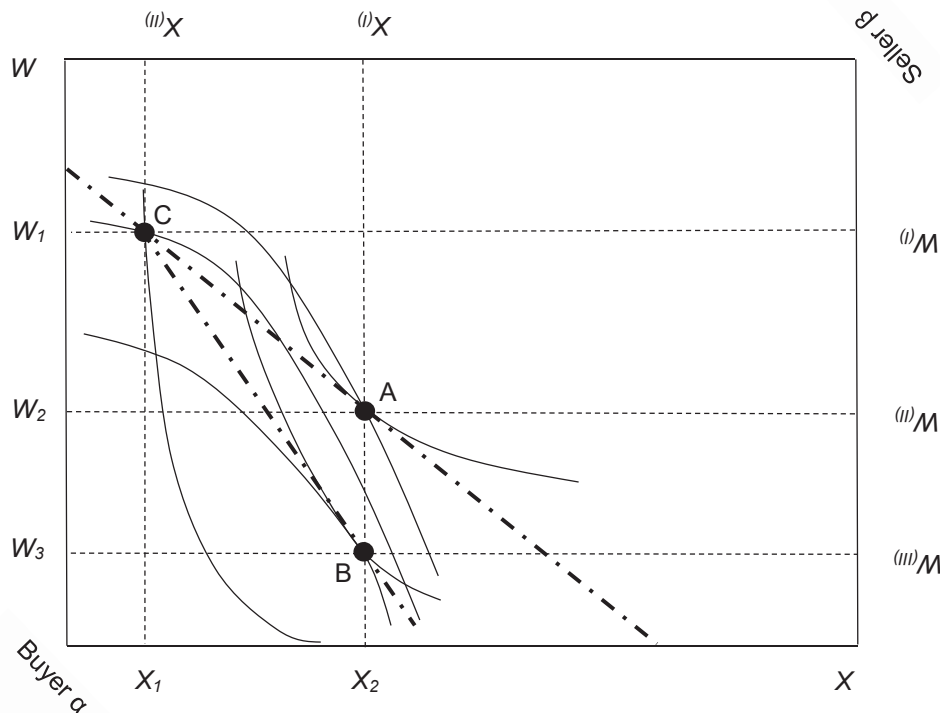
In Figure 2, the lender's situation within a usurious pseudo-contract is captured. Point C means that the subject stays in his endowment point, *i.e.*, the lender does not provide a loan. Point A represents a combination of the lender's present and future consumption if he got a transfer for free. Point B captures a combination of the lender's present and future consumption if he provided a loan for 5% interest. It holds true that $U(C) < U(B) < U(A)$. The usurious pseudo-contract offers to the lender to shift from point C to point A. Since the usurious pseudo-contract can be decomposed into the basic contract (transfer) and the super-contract (sale of the transfer for the interest-free loan), the lender faces an offer to move from point C to point A (basic contract) in exchange for a back-shift from point A to point B (super-contract).

Figure 2: Effects of usurious pseudo-contract on lender

Source: Máslo (2022b, p. 42)

6. Purchase at Unjust Price as Kaldor-Hicks Improvement

For a detailed treatise on equality in exchange and the just price, see, *e.g.*, Máslo (2022a). In a nutshell, except for the cases of an isolated exchange, the just price is the market price. In the case of an isolated exchange, the just price is equal to the seller's reservation price (for the proof, see Máslo, 2022a, pp. 15–18). Where the market price exists, the market price is the price which preserves the equality because if the seller receives the market price for his good, there is a very high probability that he can buy such a good on the market in the near future at a very similar price (plus or minus transaction costs). If the buyer paid a higher than equal price, then he would not carry out an exchange, as a matter of fact, but an exchange with a subsequent transfer. To what extent he does not want to give such a transfer, though, to that extent he does not give it voluntarily. At the same time, though, a purchase of a good at a higher than equal price shifts the buyer up onto a higher indifference curve. Again, this is a paradox of involuntary improvement. Again, its solution, as I say, consists in the decomposition of the total effect of the non-equal pseudo-contract of exchange into the effect of the basic contract (which is the exchange from the buyer's perspective) and the effect of the super-contract (which is the transfer from the buyer's perspective). Since the seller is only willing to give his consent to the equal exchange in exchange for the transfer, the seller is actually selling his consent to the equal exchange by which the seller negates the equal character of the exchange, which means the seller has nothing to sell for the transfer, which results in the same self-contradiction as in the case of the usury.

Figure 3: Effects of unjustly high price on buyer's and seller's utility

Source: Author's own preparation

In Figure 3, there is a situation of the subject α who buys the good X . Let us assume the subject only keeps the good X and the monetary wealth W . The monetary wealth W represents the monetary value of all other goods (Y, Z, \dots) which the subject has or can have as expressed in market prices. Let us assume that the subject finds himself in the point C , first, where he has a quantity X_1 of the good X and a monetary wealth of W_1 . The subject could move up onto a higher indifference curve into the point A if he bought the quantity $(X_2 - X_1)$ for the sum $(W_1 - W_2)$, i.e., at the price:

$$P_X^+ = \frac{(W_1 - W_2)}{(X_2 - X_1)}, \quad (1)$$

which is the (exogenously determined³) market price and, as a result, the equal price. Let us assume, next, that the seller will only be willing to sell him this quantity at this price if the buyer will give him a transfer of $(W_2 - W_3)$. Payment of this transfer will shift the buyer back down onto a lower indifference curve into the point B . However, this indifference curve lies still above the initial indifference curve. From the overall perspective, this is a purchase at a higher than equal price:

3 From the viewpoint of the subjects α and β .

$$P_X^* = \frac{(W_1 - W_3)}{(X_2 - X_1)}, \quad (2)$$

but in reality, this non-equal pseudo-contract (which, as we already know, is neither an exchange, nor a transfer) is a complex of an equal exchange (basic contract) and a transfer (super-contract). In effect, the buyer is compensated for the paid transfer (which shifts him down onto a lower indifference curve) by the option to buy at an equal price (which shifts him up onto a higher indifference curve). Seemingly, this is a Pareto improvement. In reality, though, this is a Kaldor-Hicks improvement, I say.

Figure 3 also shows a situation captured from the perspective of the subject β , who sells the good X at an unjustly high price. The subject finds himself in the point C, first. If he sold the quantity $(X_{(III)} - X_{(I)})$ for the sum $(W_{(III)} - W_{(I)})$, *i.e.*, at the equal price:

$$P_X^+ = \frac{(W_{(III)} - W_{(I)})}{(X_{(III)} - X_{(I)})} = \frac{(W_1 - W_2)}{(X_2 - X_1)}, \quad (3)$$

the seller would move down onto a lower indifference curve into the point A. This means that the seller is not interested in such an exchange. He is willing to carry out such an exchange, though, if he gets a transfer of $(W_{(III)} - W_{(II)})$ for it. Acceptance of such a transfer shifts the seller into the point B, which lies on an indifference curve which is above the initial indifference curve. From the overall perspective, this is a sale at a price higher than equal:

$$P_X^* = \frac{(W_{(III)} - W_{(I)})}{(X_{(III)} - X_{(I)})} = \frac{(W_1 - W_3)}{(X_2 - X_1)}, \quad (4)$$

but in reality, this non-equal pseudo-contract (which as we already know is neither an exchange, nor a transfer) is a complex of an equal exchange (super-contract) and a transfer (basic contract). The seller is compensated by the transfer (which shifts him up onto a higher indifference curve) for the equal exchange (which shifts him down onto a lower indifference curve). Seemingly, this is a Pareto improvement but, in reality, it is a Kaldor-Hicks improvement.

Point C is neither an optimum for the subject α , nor an optimum for the subject β as we can see from the fact that the tangent line to α 's indifference curve is steeper than the budget line with a slope equal to the equal price P_X^+ and the tangent line to β 's indifference curve is flatter than the budget line with a slope equal to the equal price P_X^+ . Point A is an optimum for the subject α but not for the subject β because at the equal price P_X^+ the subject α is maximizing his utility when buying exactly the quantity $(X_2 - X_1)$, while the subject β is not maximizing his utility when selling this quantity at the equal price P_X^+ . Point B is an optimum for both the subject α and the subject β because at the higher than equal price P_X^* the subject α is maximizing his utility when buying exactly the quantity $(X_2 - X_1)$, while the subject β is maximizing his utility

when selling this quantity at the higher than equal price P_x^* . However, the only way the subject α can shift from C to A (voluntary step) is by consenting to shift from A to B (involuntary step) subsequently. Since B lies on a higher indifference curve than C, though, the subject α gives his consent to this. At the same time, the only way the subject β can shift from A to B (voluntary step) is by consenting to shift from C to A (involuntary step), first. Since B lies on a higher indifference curve than A, the subject β gives his consent to this.

7. Summary and Conclusion

I tried to show that the positive – normative dichotomy is an artificially created distinction which (1) is supposed to cut off economics from its mother discipline, philosophy (such as economics was understood by Adam Smith and, paradoxically enough, by John Neville Keynes himself); and which (2) moral sceptics used to deprive moral philosophy (and metaphysics in general) of the status of science and to banish it into the field of “mere philosophy” (as Friedman does when he philosophizes about economics and, doing so, he contradicts himself hopelessly). A diehard advocate of the positive approach to economics may admit that the usurious contract is contradictory, and he may even admit that such a contract is not legally enforceable down to its contradictoriness, but to admit the injustice of such a contract is beyond the borderline of possible for a positivist. A positivist is only willing to pronounce that a consent to a contract has been manifested involuntarily by one party. Whether the involuntarily acting contractual party suffers an injustice is allegedly a philosophical question, which cannot be answered objectively. However, the statement that the question of justice is a philosophical question which cannot be answered objectively is a philosophical statement *per se*, which means that the identical objection can be raised against it. Positivism simply contradicts itself. Besides, just is to give another person what he has a right to. Another person has a right to something either by a contract, or by nature. Positivism does not know the concept of human nature, though, because it does not have a *meaningful empirical counterpart*. Again, we have Locke’s empiricist dogma, which not only is impossible to prove but which contradicts itself, on top of it. Really, there is no convincing argument why the so-called positive research should be separated from the so-called normative research.

I showed why both usury and purchase/sale at an unjust price violate equality in exchange. I put forward the arguments in favour of the thesis that a contract of exchange which violates equality is a “non-equal exchange” and, as a result, a contradictory pseudo-contract. I explained why such a contradictory contract is legally unenforceable by its nature. I pointed out what I call the “paradox of involuntary improvement”, *i.e.*, the situation where both contractual parties get better off but at least one party is acting involuntarily. How is it possible? The total effect of the pseudo-contract can be decomposed into the effect of the basic contract (desirable) and the effect of the super-contract (undesirable). In fact, the subject wants to make the basic contract

which makes him better off but he needs to “buy” the counterpart’s consent to the basic contract for the super-contract which makes him an object of external indirect coercion. Because the basic contract and the super-contract negate each other, we can call the complex of these two contracts a pseudo-contract. I say this is not a Pareto improvement but a Kaldor-Hicks improvement, where compensation is mutual. So, if the concept of the Kaldor-Hicks improvement is challenged by the objection why would one party want to compensate the other party, this paper should give an answer to this objection: a subject who gets better off by the change compensates the counterpart because the counterpart is forcing him to this indirectly. In fact, the counterpart puts the compensation as a condition of the consent to the exchange.

From the proven contradictory nature of any contract of exchange which violates equality, a twofold consequence for economic policy follows. Firstly, the state cannot legally enforce such a contradictory contract because a contradictory statement does not communicate anything. Secondly, the state must not legally enforce such a contradictory contract because the purpose of the state is to achieve the common good. Justice falls within the extent of the common good, too. A state which would legally enforce a contract which violates equality would defend injustice.

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