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## Trade restrictions on farmland - a utilitarian analysis of paternalistic laws

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## **ABSTRACT**

The aim of this paper is to approach the normative analysis of paternalistic laws. Our examples are restrictions on trade in agricultural land: a quantitative restriction in Switzerland and Germany and a fixed price range for lease land in France. We develop a normative framework from the literature and apply it to the restrictions. It shows that the quantitative restrictions apparently rest on a misunderstanding of structural change and can therefore hardly be justified, whereas the price allegation protects from information asymmetries which would lead to unfair results. Hence it can be shown that a normative analysis of paternalistic interventions can produce meaningful results.

## **1. INTRODUCTION**

Where the law neither internalises external effects, defines property rights nor provides security for transactions, it can often only be understood in economic terms if one takes into account paternalistic behaviour on the part of the state. In such cases, lawmakers suggest that the state should prevent transactions which would cause more harm than good although they are in the current subjective interest of market partners, or that it should impose certain transactions, such as the purchase of safety belts along with cars, which may be against the subjective interest of market partners. While paternalism in the legal system was long considered to be an alternative to the aim of efficiency (Kronman and Posner, 1979; Kennedy, 1982; Kronman, 1983), we owe Burrows (1995) gratitude for pointing out that paternalistic elements of the law can be entirely in line with the aim of efficiency. However, not all paternalistic interventions are efficient to the same degree. Burrows defines conditions for justifying paternalism and concludes that, “whether these conditions do prevail is a matter to be established by empirical evidence and fine judgement.” (p.490)

This paper is concerned with the identification of this “empirical evidence and fine judgement”. This is an alternative approach to lawmaking compared with the postmodern school of legal pragmatism (Landes and Posner, 1981; Posner, 2003). While the latter relies on judges’ “intuitive sense of economics (and) social wealth maximization” (Krecké, 2004; 422) and therefore the assumption of social efficiency, our approach is based on the traditional utilitarian approach of economics. Also the law can be seen as a tool for utility maximization, creating the outcome that serves society best with a given set of resources, which is not more and not less than a description of the efficiency concept. It may be a disadvantage of the pragmatist approach that inefficient rulings cannot be identified as such. Social science gains value if it can distinguish different degrees of efficiency between policy options. On the other hand, it challenges classical economic theory of individual utility maximization if the option is considered that paternalistic laws can contribute to utility maximization.

Most evaluations of paternalistic laws today, even in the social science literature, are driven more by emotional claims and general beliefs than by a firm methodology, be it in favour of (Degiorgi, 1988) or against (Dowd and Hinchliffe, 2001) paternalism. Admittedly, it is very likely that the normative analysis of paternalism will never be as straightforward as, for instance, the normative analysis of market interventions with respect to welfare effects (e.g. Rucker and Thurman, 1990). However, it would indeed be useful if an applicable normative framework were at hand which would provide evidence for the legitimization of paternalistic interventions in a democratic, market-based environment.

To contribute to the development of such a practice-oriented framework, this paper proceeds as follows: in Section 2, we summarize the status quo of the normative judgement of paternalistic interventions. In Section 3, an example of such an intervention is described. We focus on trade restrictions on agricultural land which are quite common in Western Europe. In Section 4, we then try to apply the normative framework. Conclusions are drawn in Section 5.

## **2. EVALUATING PATERNALISTIC INTERVENTIONS**

The law of most, if not all countries is full of paternalism. Most governments force their citizens into wearing safety belts, and few leave the safety of buildings fully to the interplay between supply and demand. Given the great economic impact of many of these laws, this leaves open the question of the rationale of paternalism.

On the other hand, the basic assumption that underlies economic theory is that people know their preferences, know the goods on the market and act accordingly. Any justification of

paternalism presupposes abandoning this assumption or at least allowing for exceptions. This has been strongly resisted by mainstream economists for a long time, as it would expose the whole theory of public economics to great conceptual risks. An early example is the reaction to Musgrave's (1957; 1959) definition of merit goods, goods that the state ought to deliver to a greater degree than would match aggregated consumer demand. The concept of merit goods never really got under way in mainstream economics, due to harsh criticism by Musgrave's colleagues: "I want badly to be protected from those who are convinced that they know better than I do what is really good for me, and I want others to receive similar protection." (Baumol, 1962).

Partly, this debate goes back to the difference between the two moral paradigms of perfectionism and liberalism. Paternalism is, of course, justified in a great number of cases if one adopts perfectionism as a moral standpoint (Deneulin, 2002). If certain activities such as knowledge, health or artistic creation are objectively better than others, whether one desires them or not, there are a lot of cases in favour of paternalism. Radical liberalism, on the other hand, would suggest non-intervention even in very extreme cases: consider an incident in Germany in December 2002, where one man chopped up and literally grilled another and then ate his flesh. The two had found each other via the Internet and the act was carried out in absolute consensus. Consistent liberalism would not provide a rational basis for paternalism in such a case, either. Demand and supply for human flesh had found each other.

This example leads to the observation that there are different degrees of paternalism. Our analysis does not include cases of 'soft paternalism', i.e. interventions on behalf of persons not deemed autonomous, such as the incapacitated. Economists can probably contribute less to the question about an appropriate degree of paternalism towards the mentally ill or orphans than can psychologists. Apart from soft paternalism, at the very least, it is necessary to distinguish

- government intervention which does not match market preferences, but gives (dis)incentives in accordance with the political preferences of a majority (Brennan and Lomasky, 1983; Goodin, 1989). An example would be subsidies for organic food, which most consumers support even if they do not buy organic food (Mann, 2003). However, it does not really make much sense to include this situation in an analysis of paternalism, either. The government acts in accordance with public preferences, albeit not market preferences. Paternalism, however, can only be diagnosed if the state acts in a non-consensual way.
- government intervention which does not match individual preferences in some cases, but bans or prescribes certain transactions in accordance with the political preferences of a

majority. While this situation may not qualify for paternalism from a societal viewpoint, it certainly does from an individual perspective: The state forces me into (non-)consumption without any obvious need for it.

- government intervention without public support. In democratic societies, this will only occur occasionally and in issues of minor political importance because, with this kind of paternalism in its narrow sense, governments undermine their own chances of being re-elected.

Coming back to the example of interventions in human flesh trade, this is an example of the second category, government intervention against individual preferences, but in favour of the majority's political preferences. While most economists today are clearly more on the side of liberalism than of perfectionism, even they would probably support paternalistic intervention in such extreme cases. Without offering a final solution in the debate between perfectionism and liberalism, we suggest that some strong moral norms which are generated by deliberative processes within human society (Habermas, 1991) justify paternalism. Moral feelings are, after all, highly relevant sources of justification for societal behaviour. An interesting point in the debate about ethics in economics is that philosophers increasingly cease to formulate ethical norms themselves. 'Ethical authoritarianism' (Head, 1974) increasingly loses its acceptance. Instead, philosophers start to accept local norms supported by a broad majority of citizens (Rorty, 1988; Rawls, 1993). One can argue that a society as such cannot sustain itself if certain individuals are allowed to do what most people despise. This demand on the part of society is called "common obligations" by Mead (1986), "moral sense" by Wilson (1993) and "a voluntary moral order" by Etzioni (1997). This is one way to explain not only the ban on (even consensual) cannibalism in most of the world, but also on going around naked outdoors in the United States or drinking alcohol in Pakistan.

It is never easy to find a common language between economists and moral philosophers. Therefore, one has to go back to the basics of utilitarian theory to argue why interventions for moral reasons will increase overall efficiency. Only in some cases will such paternalistic interventions affect economics at all: by banning the market for alcohol in Pakistan more than by banning nudism in the United States. But that is not the point. To use economic terminology: by the inappropriate behaviour of certain individuals, the aggregated utility of all those who are watching is presumably diminished to a greater degree than the utility of the individual is increased. This is how government intervention can increase overall utility and therefore societal efficiency.

Paternalism without public support is much harder to justify. Probably, it is only appropriate in cases of information asymmetries (New, 1999; Leonard et al., 2000). It is well known that information asymmetries weaken the position of the party with less information. It is common

for individuals to hire experts, such as medical or investment advisors, in cases where unfamiliar or complex decisions have to be made. In cases where they do, even if they delegate decision-making because they know that others know better, no paternalism whatsoever is involved. The case for paternalism arises only if persons do not know that they do not know enough.

While the argument for paternalistic interventions due to information deficiency is an old one (Head, 1969), so are doubts about its legitimation. In the case of information deficiencies, the state has two options: it can either provide a sufficient amount of information for the consumer, or decide to supply the goods itself. Mackscheidt (1974) and Erlei (1992) assume that the cost of information supply will necessarily be less than the cost of the public provision of the goods. But neither is this inevitably true, nor does it help in all cases. Providing everybody with complete information on sophisticated issues can cause prohibitively high transaction costs. But worse: even fully-informed individuals will sometimes make poor choices. Not everybody is able and willing to process every bit of information in an adequate way. This provides some justification for protecting them from themselves, for paternalistic interventions without public support.

No matter how necessary paternalistic interventions may be, they will always have shortcomings with respect to the aim of freedom. The freedom to make choices has an intrinsic value, firstly because the act of choosing is character-developing and improves the ability to do so (Dworkin, 1982; Sen, 1988), secondly because having the right to choose gives people a feeling of being in control (Gahagan, 1991). Thus, every efficiency gain through paternalism has to be weighed against the loss of freedom.

### **3. THE CASE OF TRADE RESTRICTIONS FOR FARMLAND**

In most European countries, trade in farmland is subject to plenty of restrictions. Restrictions against converting farmland into residential land can easily be explained by the external effects of land sealing. Other restrictions can possibly be explained by Public Choice Theory applied to agriculture (Hagedorn, 1989; Tullock and Hillman, 1991), i.e. the pressure of farmer groups and the vote-maximizing strategy of politicians, if they serve farmers' interests over the interests of non-farmers. Among them are widespread restrictions on non-farmers buying agricultural land (Gatterbauer, 1991), or a systematic undervaluation of farms in successions so that non-farming siblings are compensated with only a small sum of money (Köhne, 1995).

Our interest, however, is directed towards a group of legal restrictions that can neither be explained by external effects nor serve the subjective interests of farmers. Two such examples of paternalistic policy will be analysed below.

The first are restrictions on whether farmland may be traded at all. A particularly restrictive example is the Swiss law which principally forbids selling farmland off an existing farm. Art. 58 of the agricultural land law states that “single lots may not be split off from agricultural enterprises.” Exceptions are only granted if it can be shown that the overall farm structure is improved, a claim that usually has to be proved in court. In Germany, the law works vice versa: sales of farmland are allowed in general, but forbidden if, according to § 9 of the Grundstückverkehrsgesetz (land trade law), the agricultural structure is impaired or if “a self-dependent farm would lose its viability”.

The second case regards price margins for farmland transactions. They are in fact more common for land lease than for land sales. If, however, price restrictions are one-sided, they are likely to serve the interests of one particular group and should be left for analysis to public choice theorists. Swiss agricultural lease law, for example, prescribes lease prices well under market equilibrium and therefore serves the interests of farmers as against the interests of landowners. A different example is provided by article 411-11 of the French code rural: this requires the Départements to set a price range which is derived from the past production capacity of the land and past land lease prices, both in the region in which the minimum and maximum price are relevant for the market partners.

Both restrictions, on the quantity of traded land and on the price of lease land, are of paternalist origin. Neither internalises external effects nor does it strengthen the position of farmers in general. Both seem inspired by the thought that the state should prevent transactions which may be in the subjective interest of market partners, but not in their objective interest. It is worthwhile checking whether this notion holds up under an economic analysis.

## **4. NORMATIVE ANALYSIS**

### **4.1 Welfare Analysis**

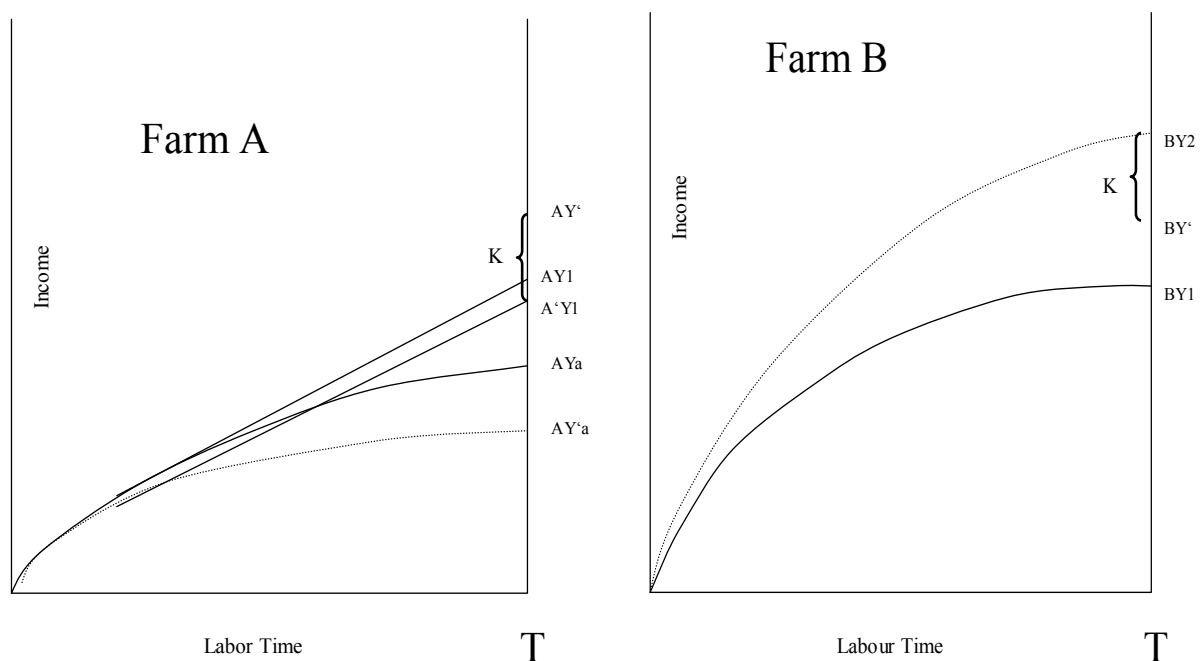
Before we seek justification for paternalistic interventions, it seems worthwhile to follow the conventional normative methodology of economists and check for the potential welfare losses of the two respective laws. The question is whether good reasons in favour of paternalism would have to outweigh large or small losses from conventional welfare economics.



Starting with the ban on splitting off land from an existing farm, one has to refer to Schmitt's (1989) Theory of the Farm Household, which clarifies the strong interdependencies between farm and household in agriculture. Schmitt assumes that the marginal returns of on-farm labour decrease with increasing time input, while the marginal return of off-farm work is constant. Hence, there is some likelihood that a combination between on-farm- and off-farm labour will produce maximum profit for the household.

An example may show the relevance of this approach for land trade between farmers (Figure). Farm A is a part-time farm which, investing all labour time  $T$  in agricultural labour, could earn  $AY_a$ . By combining on-farm labour with off-farm labour, however, it manages to increase its income to  $AY_1$ . Farm B has a higher agricultural income potential, which enables it to earn  $BY_1$ . There is no option of off-farm work, possibly because of a lack of qualifications.

By transferring a certain piece of land from Farm A to Farm B, the possible agricultural income of Farm A decreases to the dotted line, which means to  $AY'_a$ , if Farm A spends time  $T$  as its labour input. That means that the earned income of Farm A decreases to  $A'Y_1$ . The earned income of Farm B, however, increases to the dotted line, with full labour input to  $BY_2$ .



*Fig.: Economic impact of a land transfer from Farm A to Farm B*

Assuming that Farm B has to raise a mortgage in order to buy the land, which causes capital costs of  $K$ , the household income of Farm B will thus be  $BY'$  after the transaction. Farm A invests the revenue from the land sale and earns an additional capital income  $K$ . That

increases the household income from AY1 to AY'. Hence, both market partners could increase their household income through the transfer of land, without causing harm to a third party. Too bad that the transaction would have been prevented by law in Switzerland and Germany: in Switzerland because any partition of land from an existing farm is forbidden and in Germany, because the new agricultural income of Farm A is too low to ensure the farm's "economic viability".

The welfare analysis of a legal price range for land lease contracts is more straightforward. Given the relatively narrow range and the large diversity of soils, it is likely that the price range will lead to two different kinds of distortions: to an oversupply of land with a low production capacity which is not in demand at the legal minimum price, and/ or to excess demand for good land for which more than one applicant is willing to pay the legal maximum price. The first case will make the land-owner either sell the piece of land or farm the land himself. The second case diminishes the controlling function of price. The land will not necessarily be farmed by the person who expects to earn the greatest revenue from it.

Both cases entail welfare losses which result from the intervention in the price formation process. Their extent depends on the position and span of the legal price range and on the diversity of soils. The better the respective Département manages to account for the differing soil qualities, the more avoidable are such welfare losses. Intuitively, it may appear that the potential welfare losses resulting from banning trade in land are far greater than the welfare losses arising from the exclusion of some equilibrium prices.

## 4.2 Analysis of Political Preferences

This section is dedicated to checking whether the political preferences of the population involved are justification enough to intervene in the market for agricultural land, i.e. whether a large majority of the people demanded restrictions on farmers' freedom to trade land among themselves. Although it could be shown above that this is a most necessary step in order to seek legitimacy for a lot of paternalistic interventions, it becomes a difficult task in the case of agricultural land laws. Agricultural land laws are, at least in most industrialised countries, not a matter of intense debate, social movements and strong opinions. In the French and German case, the land laws are many decades old and when details of them have been changed, not many people have noticed. In the face of such obvious lack of public interest, it seems impossible to diagnose a moral public demand for limiting trade in agricultural land.

One of the few valuable clues for our analysis is a plebiscite which took place in Switzerland in 1992. The agricultural land law was to be condensed from a lot of single articles in different places into one coherent law at that time. The previous situation was partially contradictory. To name an example, the cantons were free to allow partition of farms

whereas articles at the federal level forbidding the partition of farms could only partially be enforced. However, in the course of proposing the law to voters, a problem very typical for direct democracies arose: in order not to overstrain voters, all the provisions of the land law were bundled together and had to be decided by one plebiscite. This left little freedom for voters to differentiate between the single parts of the reform, although very different propositions were included in the law: valuation questions in cases of inheritance, the division of competences between farming couples in the case of land sales and the proposed ban on splitting single plots off the farm. Voters who were opposed to some of the proposals and in favour of others had no choice but to weigh the advantages against the disadvantages of the whole package and then make a decision.

Only a large majority of voters would have shown that there is a case for intervention in farmers' decisions whether to sell some of their land. However, the result of the plebiscite with a participation rate of 46 per cent was not too clear-cut. It was a sharp majority of 53 per cent of voters who were in favour of the reform. What is more, the article which would ban a split-off of single pieces of land was never at the centre of interest of the (modest) public debate concerning the plebiscite. Other articles, such as the ban on non-farmers purchasing land, were more intensely discussed between supporters and opponents of the bill.

While it is obviously too technical a matter to evoke interest among citizens whether the state sets a price range for agricultural lease land, the ban on splitting off land from a farm also cannot be found to be justified by broad public "moral" support, either in Switzerland or in Germany, where public knowledge about the prevailing restrictions might be even more scanty than in Switzerland. To seek justification for the paternalistic intervention, one should therefore enter the field of information economics.

#### 4.3 Information asymmetries

It is not easy to find an explicit justification in the literature for the ban on selling off land from an existing farm. But what obviously plays a role is the negative historic experience of Realteilung in the rural areas of Switzerland and Southern Germany: farms which became smaller and smaller in the course of generational change and which, to a growing degree, failed to provide a sufficient basis for living. The other side of the coin, and also occasionally discussed in the public sphere, is farms which over-invested and therefore over-indebted themselves. Given the exceptionally high land prices in Switzerland by international standards (Giuliani, 2002), it is indeed possible to ruin a farm with excessive land purchases.

The paternalistic presumption for the ban is therefore information asymmetries. The state has to protect the farmer from ruining himself, either by selling land which he needs in order

to make his living or by over-indebting himself through land sales. Indeed, from a utilitarian standpoint it can be argued that a paternalistic intervention would be justified if the state has the information that two farmers would ruin themselves with a transaction which they voluntarily enter into.

There will be few doubts that the perceived danger exists. There will be farmers who would like to sell some of their land although a sober analysis would show that this will erode their income basis, and there will be farmers whose thirst for more land will throw them into financial turmoil. But that is not the main question. The main question is about what Leonard et al. (2000) call target inefficiency. Presumably, the state will not be able to distinguish between farmers who know what they are doing, farmers who do not know but successfully rely on their consultant, and farmers who are ignorant and should be protected from themselves. If the state cannot successfully discriminate, universal interventions to benefit the ignorant risk injuring the non-ignorant. To be justified in terms of a cost-benefit analysis, the costs of injuring the non-ignorant have to be outweighed by the benefits of protecting the ignorant.

Such a cost-benefit analysis cannot, of course, be carried out literally, at least not in our example. But one can look for parallel cases and note how society decided there. Consider that farming is just one economic sector among others. But in other sectors the issue of entrepreneurs being forbidden to sell parts of their firms or to buy parts of other companies is rarely discussed, let alone implemented, unless monopolies thereby arise. Usually, it is common sense in market economies that every company knows better than the state what items to sell and what to acquire. Thus, in general, it is believed that the harm done by preventing such transactions is greater than the protective benefit of banning such sales.

As mentioned, the reason for the exceptional situation in agriculture can be found in the past centuries, when it was common for a father to divide his farm among his sons, often leaving each with too little to live on and too much to die for. It would probably justify paternalistic intervention if the danger of this process continuing were high. But for the past 100 years or so, the structural development of agriculture has strongly turned in the opposite direction. Throughout Western Europe, the number of farms has considerably decreased, much more often leaving no successor once the farmer retires than the necessity of dividing a farm into several parts. The main motor of the development toward fewer, larger farms was a steep rise in opportunity costs due to growth processes in other sectors. While 200 years ago, the farmer's sons had few choices except carrying on with agriculture, they can now choose between a broad variety of different jobs in industry or the service sector. The level of opportunity costs has risen considerably during the last few centuries, for farmers' siblings at the start of their career as well as for farmers who can now decide to invest some of their

labour time in sectors other than agriculture. It has been shown that structural change in agriculture follows rational principles as much as structural change in other sectors (Mann and Mante, 2004). Our argument is that paternalistic intervention in land trade is based on patterns which ceased to exist a long time ago.

The justification for allowing only a certain price range for lease land is certainly not easier to find in the literature than the justification for banning land trade. But it is likely that information asymmetries play a crucial role in the motivation of this provision, too. Farmers and landlords are protected against paying far too much or against receiving far too little for a piece of land, measured against usual market prices.

It is difficult to argue that the prescribed price range enhances efficiency. If I lease a piece of land and pay 1,000 Euros for it, although the landlord would never have been able to lease it for more than 500 Euros to somebody else and would have been perfectly happy to earn the 500 Euros for it, this is not inefficient from a societal point of view. It is merely a redistribution of funds from me towards the landlord which is probably due to my uninformedness regarding the going rates for land. Only by the argument of justice would it be possible to defend the price range laid down by law. One could perceive it as unfair that I am not protected from paying moon prices or from receiving much less than what my asset is worth.

Again, one has to ask what difference agriculture makes. Why would we need price ranges for lease land, but not for factors like machinery, chemicals or software? The answer is twofold: on the one hand, the fragmented structure of farming, with its thousands of small enterprises, makes it particularly difficult to follow all the relevant market developments for farmers. It causes high transaction costs if each farmer has to collect every bit of the information he needs from different sources. On the other hand, land is a very central factor for farming, and it costs less effort for the state to provide information about land prices than to provide information about, for example, the range of substances which the chemical industry needs.

Many governments, from Alberta to Germany, give free information on prices to their farmers, thereby probably saving transaction costs for time-consuming information searches. The distinctive step taken by the French government in the land market is that not only does it provide information, it forces farmers to make use of it. This allows the government to intervene in cases where the information has not made its way to the farmer or the landlord. Again, only the fragmented structure of farmers and landlords, both sometimes dwelling in remote areas with little informational activity, can justify such a step for the sake of distributional justice.

## 5. SUMMARY AND CONCLUSIONS

It was the aim of this article to develop and apply a useful framework for the analysis of paternalistic interventions. Indeed, it could be shown that different paternalistic interventions can be justified to different degrees with different arguments, as summarized in the Table. One has to take into account that such interventions will usually entail some welfare losses. And one has to weigh these losses against efficiency gains and increased justice which arise through the fulfilment of political preferences and/or through the correction of information asymmetries.

The two cases of paternalistic interventions which were examined show that, although no quantitative cost-benefit analysis can be carried out, some judgements can be made. The presumptions on which the ban on trading land among farmers in Switzerland and Germany is based are probably outdated and no longer valid. The paternalistic intervention is based on a misunderstanding of the patterns of structural change in agriculture. The paternalistic prescription of a price range for lease land in France, however, seems to be based on more realistic assumptions: that in the highly atomised market for land, some unconscious information asymmetries exist and they can only be overcome if the state forces market partners to make use of free public information. In this case, it may well be that paternalistic intervention increases the fairness of the market to a degree that outweighs the unavoidable efficiency losses.

Table: Summarizing arguments pro and contra paternalistic interventions

	<i>Welfare effects</i>	<i>Political preferences</i>	<i>Information asymmetries</i>	<i>Overall judgement</i>
<i>Ban on trading land among farmers</i>	Considerable losses likely	Hardly measurable	Hardly a justification	Intervention cannot really be justified.
<i>Prescribed price range for lease land</i>	Losses for extreme conditions possible	Probably none	Intervention may improve justice.	Intervention can be justified

This is only a blueprint for a methodology to evaluate paternalistic interventions by the state. It seems worthwhile for future research to invest more effort in a normative analysis of paternalism. The unsatisfactory alternatives are generally to dismiss or hail all paternalistic interventions, or to refrain from making any normative judgement. Making a distinction, however, should strengthen the normative power of public economics.

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