



**WELFARE ECONOMICS THEN
AND NOW**

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- “Then” is 1957:
- J. de V. Graaff (1957),
- *Theoretical Welfare Economics*
- Cambridge University Press

- Reprinted in 1967 with foreword by
- Paul Samuelson

- Presentation
 1. The book
 2. The context
 3. Core arguments
 4. Welfare economics now

- **1. The book**
- Research monograph of 178 pages
- Analytical, but mathematics confined to four chapter appendices
- 12 chapters
 - Beginning and end (chapters I and XII)
 - Core argument (chapters II to V)
 - Extensions (chapters VI to VIII)
 - Applications (chapters IX to XI)

- Beginning and end
- *“Theoretical welfare economics proceeds from a number of definite assumptions, factual and ethical, which are seldom stated explicitly. If their nature were more widely appreciated by professional economists, it is improbable that the conventional conclusions of welfare theory would continue to be stated with as little caution as is at present the custom.” (p.1)*

- *“In my view the job of the economist is not to try and reach welfare conclusions for others, but rather to make available the positive knowledge – the information and the understanding – on the basis of which laymen (and economists themselves, out of office hours) can pass judgement.” (p.170)*

- Welfare economics is normative economics
- Where is the positive/normative boundary?
 1. “What determines the price of wheat?”
(**positive**)
 2. “Has the real national income increased?” (?)
 3. “Should a protective tariff be placed on imports?” (**normative**)

Graaff argues 2. is normative too –
connotation to laymen is that increase in
national income must be a good thing

- Prices and quantities are observable but welfare is not
- *“..whereas the normal way of testing a theory in positive economics is to test its conclusions, the normal way of testing a welfare proposition is to test its assumptions.” (p.3)*

- *“If two people disagree on the contributions which various levels of individual well-being make to social well-being, it is extraordinarily hard to think some objective test which would settle the matter to the satisfaction of both. The question is therefore an ethical one.”*
(p.167)

- **2. The context**
- In 1957 economists were not yet writing books on microeconomics and macroeconomics
- They were writing books on welfare economics, e.g.
- I M D Little's *A Critique of Welfare Economics* (1951/1957)
- W J Baumol's *Welfare Economics and the Theory of the State* (1952)

- The three frequently recurring citations are to
 - Pareto
 - Pigou
 - Samuelson
- Not neglecting:
 - **Bergson**, Hicks, Kahn, Kaldor, Lerner, Marshall, **Scitovsky**
- But **not** featured:
 - Arrow (1951), “An extension..” and Debreu
 - Lipsey, Lancaster and the second best

- **3. Core arguments**
- *Chapter II – Technology*
- *“A large and important part of welfare economics can be pursued at the engineering level.” (p.14)*
- Sets out transformation functions (PPFs) both at the individual level (man, not firm) and the social level
- External effects not excluded

- *Chapter III – Tastes*
- A Scitovsky set:
- $S(X_1, \dots, X_n) = 0$
- i.e. minimum X_i given other X that satisfy the *prescribed* indifference curves
- $u^\alpha(x) - c_\alpha = 0 \quad (\alpha = 1, \dots, v)$
- where $X_i = \sum_\alpha x_i^\alpha \quad (i = 1, \dots, n)$
- Repeat for all indifference curves

- Bergson frontier:
- $B(X_1, \dots, X_n) = 0$
- i.e. minimum X_i given other X that satisfies
- $W(u^1, \dots, u^v) = \bar{W}$
- i.e. minimum quantity of one good – given others – to attain given social welfare
- Bergson frontier is the inner envelope of the Scitovsky community indifference curves
- Satisfies equality of marginal rates of substitution

- *Chapter IV – Potential Welfare*
- Puts together production and exchange to discuss the “General Optimum”, attributed to Pareto and Pigou
- Represented by tangencies between Bergson frontiers and social transformation curves
- Then re-expressed in terms of the welfare frontier (the utility possibility frontier) in utilities space
- Tangencies with contours of social welfare function

- *Chapter V – Feasible Welfare*
- Two distinct things:
- (a) What moves can be achieved with taxes and bounties that are not lump-sum
- (b) Compensation tests and their (lack of) welfare significance – *“Professor Hicks gives [the compensation test] a definite welfare connotation that would be legitimate only if the compensation were actually paid.”*

- **4. Welfare Economics Now**
- Welfare economics *then* was a distinct part of economics
- Not clear that this is true *now*: this material now covered in the general textbooks and specialist treatments appear rare
- In the general treatments not a lead item – can be crowded-out by consideration of more active areas of research

- Earlier quoted Graaff's statement about economists providing positive knowledge on the basis of which laymen can pass judgement
- Seems to set the bar very high for the laymen (and for us, out of office hours)

- The approach of public economics appears more fruitful:
 - specify a range of social welfare functions
 - specify the set of constraints
 - optimise
 - ..and interrogate the findings
- THANK YOU – COMMENTS WELCOME