

- **Ethical Basis of Welfare Economics**

- **Ethics typically deals with questions of “how should we act?”**

As long as choices are personal, does not involve public policy in any obvious way

Many ethical questions though have both personal and public dimensions

- **A *social contract* is one way of handling the ethics of public policy - an implied agreement among members of society to accept a set of rules making social cooperation possible**

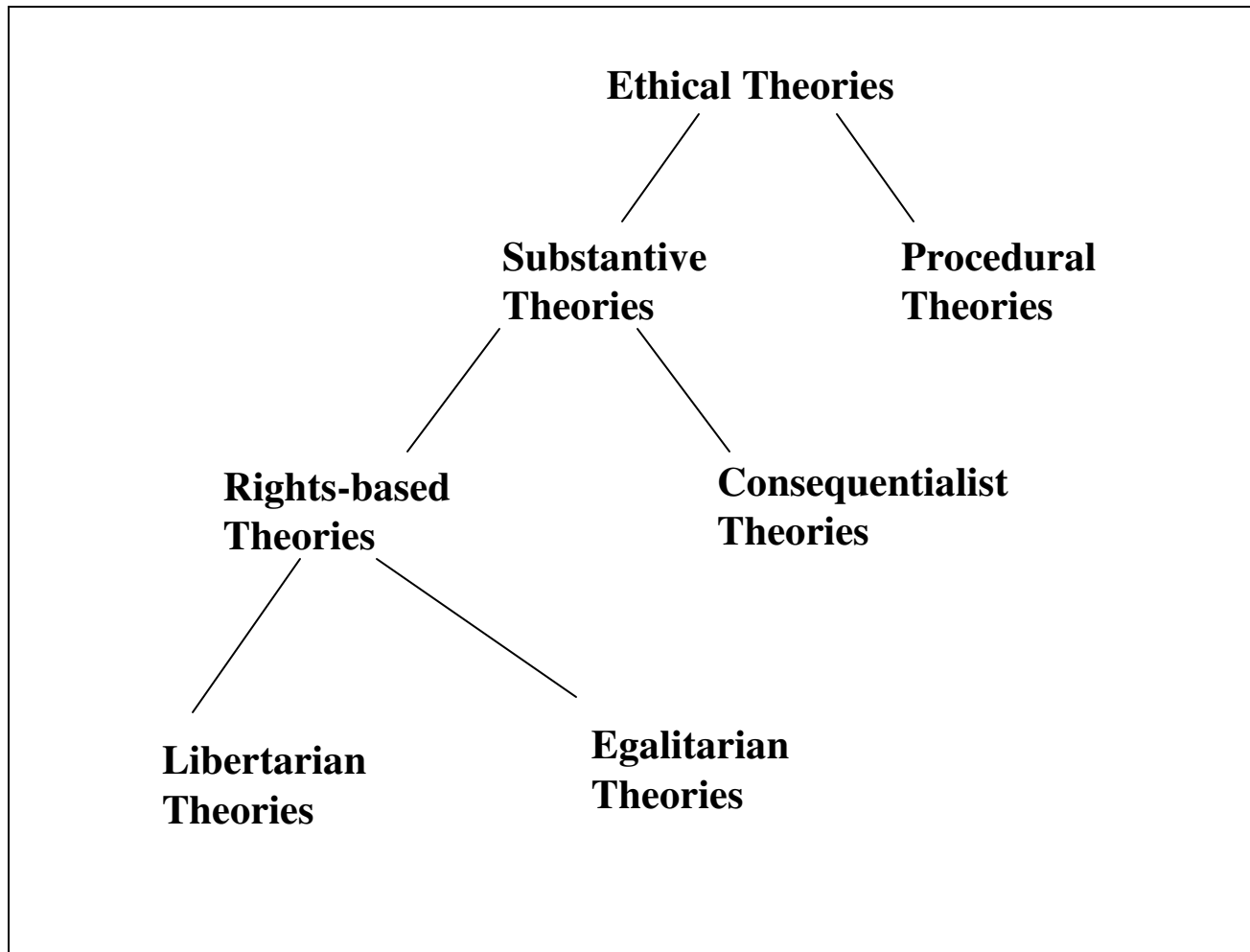
Two philosophical questions have to be addressed:

- **what are the terms/rules of the social contract?**
- **why should someone agree to the contract?**

- **Specifying terms/rules of the social contract:**

- ***substantive ethical theories*: rules/principles specifying goals of society and policies that should be adopted**

Figure 1: Types of Ethical Theory



- *procedural ethical theories*: analyze ways in which laws, policies, or regulatory principles are enacted

■ **Substantive Ethical Theories:**

- *consequentialist* theories evaluate policy in terms of outcome - *utilitarianism* most common → policy should result in greatest benefits for public at large

- *rights-based* theories evaluate policy according to certain uncompromisable rights

(i) *Libertarian theory* - government has a duty to protect life, liberty, and property of citizens from interference from others, but not protect individuals from their own mistakes

(ii) *Egalitarian theories* - government should not only protect life, liberty, and property, but also ensure a minimum quality of life, and equal opportunity

■ Rights-Based Theories

Hobbes (1651) and Locke (1697) believed main goal of government was to establish legal protection of rights thought to be *natural*

- citizens' claims to rights of life, liberty and property should be protected, and monarchs' claims to "divine right to rule" should not

- citizens should voluntarily accept the moral force of such rights as consistent with self-interest

(i) Libertarian theories limit scope of public policy to enforcing laws against assault, theft, and other harmful acts, and providing for common defense

If there were no social contract, "life would be nasty, brutish, and short" (Hobbes), so individuals have an incentive to seek some mutual protection

Libertarian rights can be thought of as *negative* rights, i.e., individuals in a society are constrained not to violate someone else's rights

Major problem is maximizing individual freedom without society degenerating into anarchy

Some restraints on individual choice are needed, but libertarians have a hard time deciding what restraints are appropriate

Nozick (1974) argues in *Anarchy, State and Utopia*,

“...a minimal state, limited to the narrow functions of protection against force, theft, fraud, enforcement of contracts, and so on, is justified; that any more extensive state will violate persons’ rights not to be forced to do certain things, and is unjustified...”

The initial state of the world is anarchy, with no recognition of rights of others, insufficient to allow peaceful co-existence – from which a dominant agency supplying protective services will emerge

Due to free-rider problems, agency will have to adopt coercive taxation to finance its operation as a “night-watchman”

Only public good in such a state is protection, consequently, there is limited redistributive activity – but if greater provision is Pareto-improving, why is it not allowed?

Contractarianism seeks to avoid this problem by maximizing individual freedoms while avoiding anarchy (Buchanan and Tullock, 1962)

The basic contractarian principle is that of Pareto *safety* - no change that visits uncompensated harm on anyone should be permitted, i.e., change should only occur with unanimous consent

Individuals acting in their own self-interest will agree to public policy measures, and since they would need no coercion, no violation of individual rights is involved

Implies voluntary exchange of private goods and voluntary taxation for provision of public goods

Places great importance on property rights and compensation for individuals that would otherwise be made worse-off due to actions undertaken for the public good

Protects the status quo - however, Pareto safety can only be justified if status quo itself is justified (Buchanan, 1977) - implies unanimous adoption of a starting constitution

The lack of a constitutional stage makes both libertarianism and contractarianism seriously flawed

(ii) Egalitarian theory includes all negative rights of libertarian theory, plus some *positive* rights

For a libertarian, right to life is a right not to be killed by another individual, while for an egalitarian it includes some assurance society will act to prevent an individual's death from other causes

Egalitarian theory also recognizes notion that every rational person wants a share of things that make a decent life possible

Known as *primary goods* (Rawls, 1985), e.g., food, shelter, security, and some discretionary income - also includes opportunities to learn, work, and increase ones allotment of other primary goods

Theory implies that property may have to be taxed to ensure such rights - would the wealthy accept such a challenge to the absoluteness of their property?

Rawls argues that rational individuals will not risk being destitute, and so will choose a social contract that guarantees everyone certain minimal rights, e.g., right to a healthy, secure, and free life

Egalitarian theory does not necessarily imply an equal distribution of income - would likely result in low level of economic development

Rational individuals would not want to preclude possibility of economic growth - discretionary holding of money and real property would be allowed - implies a limit to practice of taxing wealth

■ **Utilitarian Theory**

Bentham (1789) thought concept of natural rights was nonsense - anyone could claim a right to something they wanted, and it would be a matter of power and privilege to have such a claim validated

Rights-based theories provided no insight into the ideals to which public policy should aspire

Bentham proposed the social contract as an ordinary contract supplying a set of benefits from public policy at an established price

Standard by which to judge contract is whether it produces the greatest benefit for the greatest number of people - a policy that does so is right

Utilitarianism has to define both *scope* and means of measuring relative *value* of consequences of public policy (*axiology*)

Generally agreed scope should cover all effects of a particular policy, and theory of value uses term *benefit* to refer to a desirable consequence, and *cost* as an undesirable consequence, any valued consequence being defined in terms of *utility*

Bentham thought of good and bad in terms of pleasure and pain - *hedonic utilitarianism*, where:

- everyone's pleasure and pain counts equally
- value arises from the way individuals experience outcome of a policy

Problem here is that experiencing pleasure or pain is an objective fact, but actual pleasure or pain is a subjective experience - generates a practical measurement problem

An alternative is *preference utilitarianism* - individuals know what is good or bad for them, hence, an optimal outcome is one where they can choose for themselves

- In addition to scope and axiology, theory must contain a *decision rule*, i.e., a means of determining which policy option is right one to choose

(i) *Utilitarian maxim* - right public policy is that which generates greatest utility for greatest number of people (Bentham; Mill)

- right policy is one that provides maximal pleasure

- right policy is that which maximizes satisfaction of individual preferences

This decision rule can justify policies where some individuals are harmed

(ii) *Pareto principle* - only accept policy outcomes that make at least one individual better off and no individual worse off

Practical problem is that policy options typically harm some individuals, Pareto principle has been modified:

- *pure Pareto improvement* - beneficiaries of public policy should compensate losers

- *potential Pareto improvement* - it may be impractical for winners to compensate losers, but the former have enough benefits that they could compensate the losers if it were possible to do so (Kaldor-Hicks criterion)

■ **Utilitarianism likely to permit policies that rights-based theories might reject, e.g., soil conservation policies easier to justify in utilitarian terms:**

- soil conservation policies may impose costs on a small number of producers in short-run, but will generate benefits for a larger number of individuals in terms of a secure and stable food supply

- utilitarian, Kaldor-Hicks criterion, and even Pareto principle would support conservation

Under libertarian theory, public policy likely has no warrant in interfering in use of privately owned land unless rights of others are violated

Under egalitarian theory, while it is reasonable to ensure present individuals are fed, difficult to say how far this entitlement extends into the future

■ **Will rational individuals be ruled by a utilitarian social contract?**

- **element of common sense in idea that policy should seek greatest good**

- **direct language of consequences keeps individuals informed of intentions of policy**

- **social contract is common objective, natural to express it in terms of common good - talk of greatest good for greatest number binds individuals together, while talk of individual rights may set them against each other**

- **individuals recognize government offers a means of cooperation to avoid *prisoner's dilemma* type situations - government has coercive power to ensure mutually beneficial outcomes are achieved**

■ **Problems with utilitarianism:**

- **preferences not subject to interpersonal review or substantive tests against principle and reason, “...Socrates unsatisfied should have more moral weight than a pig satisfied...” (Mill)**

- does not take distinction between persons seriously (Rawls, 1972). Criterion of greatest good for the greatest number might be satisfied by an action causing great harm to a few to provide relatively trivial benefit to many

- Kantian ethics would also take issue with notion that preferences are sufficient guide to correct action, i.e., aesthetic judgment, intrinsic value and moral principle can outweigh preferences in many circumstances

Utilitarians would recommend biodiversity be preserved insofar as benefits of doing so outweigh costs

Kantians would preserve biodiversity because we (society) believe we ought to protect species as “ends in themselves”, i.e., it is a matter of collective responsibility not individual satisfaction