WELFARE ECONOMICS AND ETHICS

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WELFARE ECONOMICS AND ETHICS

- *Social contract* is way of handling ethics of public policy – implied agreement among society to accept rules for social cooperation

- **What are terms of social contract, and why would someone agree to them?**

- **Ethical theories specify goals of society and policies it should adopt**

- **Two types of ethical theory:**

  - **those that evaluate policy according to certain *rights*, e.g., *libertarian* theory**

  - **those that evaluate policy in terms of outcome, e.g., *utilitarianism***

- *Libertarian* theories limit 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, 1651) – individuals have incentive to seek mutual protection

- Due to free-riding problem, government will have to adopt coercive taxation to finance its operation as a "night-watchman"

- Only public good is protection, with limited redistributive activity

- If greater provision is Pareto-improving, why not allow it?

- *Contractarianism* seeks to maximize individual freedoms while avoiding anarchy (Buchanan and Tullock, 1962)

- **Basic principle is Pareto *safety* – no change that visits uncompensated harm on anyone should be permitted, i.e., change occurs with unanimous consent**

- **Individuals acting in own self-interest will agree to public policy measures, and since there would be no coercion, no violation of individual rights occurs**

- **Places great importance on property rights and compensation for individuals that are made worse off due to actions undertaken for public good**

- **Pareto safety can only be justified if starting point itself is justified**

- *Egalitarianism* includes rights of libertarian theory, plus additional rights

- For libertarian, right to life is 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 share of things that make a decent life possible, i.e., *primary goods* (food, shelter, security and discretionary income)

- Implies property might have to be taxed to ensure such rights – would wealthy individuals accept such a challenge to the absoluteness of their property?

- **Rawls (1985) believed that everybody starts from behind a *veil of ignorance*, i.e., you know nothing of yourself and abilities, nor your place in society**

- **Rational individuals will not risk being destitute, and will choose social contract that guarantees certain minimal rights, e.g., healthy, secure and free life**

- **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 property allowed – implies limit to practice of taxing wealth**

- **Bentham (1789) thought concept of rights was nonsense – anyone could claim a right and it would be a matter of power and privilege to validate such a claim**

- **Bentham proposed social contract supplying set of benefits from public policy at an established price**

- **Scope covers all effects of policy, with terminology of *benefit* for desirable consequences and *cost* for undesirable consequences**

- **Consequences defined in terms of *utility*, i.e., correct public policy generates greatest utility for greatest number**

- **Utilitarianism implies all individuals count equally, although can be generalized to allow for weighting**
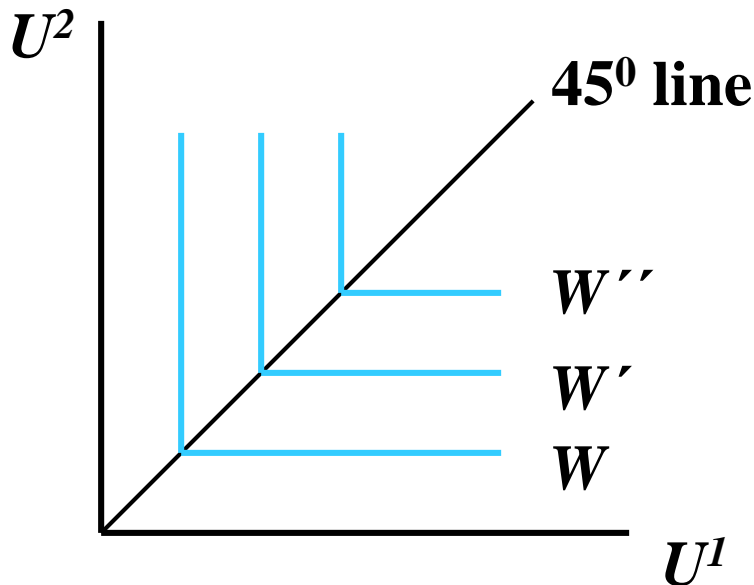
Figure 1: Utilitarian
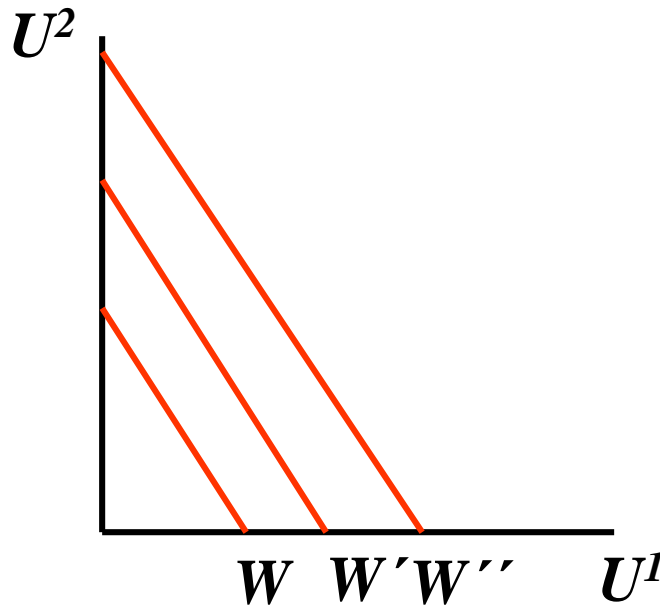
- **Utilitarian or Benthamite social welfare function W defined over H households, each household h being treated with equal weight:**

$$W = \sum_{h=1}^{H} U^h, h = 1,...,H$$

Implies straight line social welfare contours that are not biased in favor of one group's utility over another
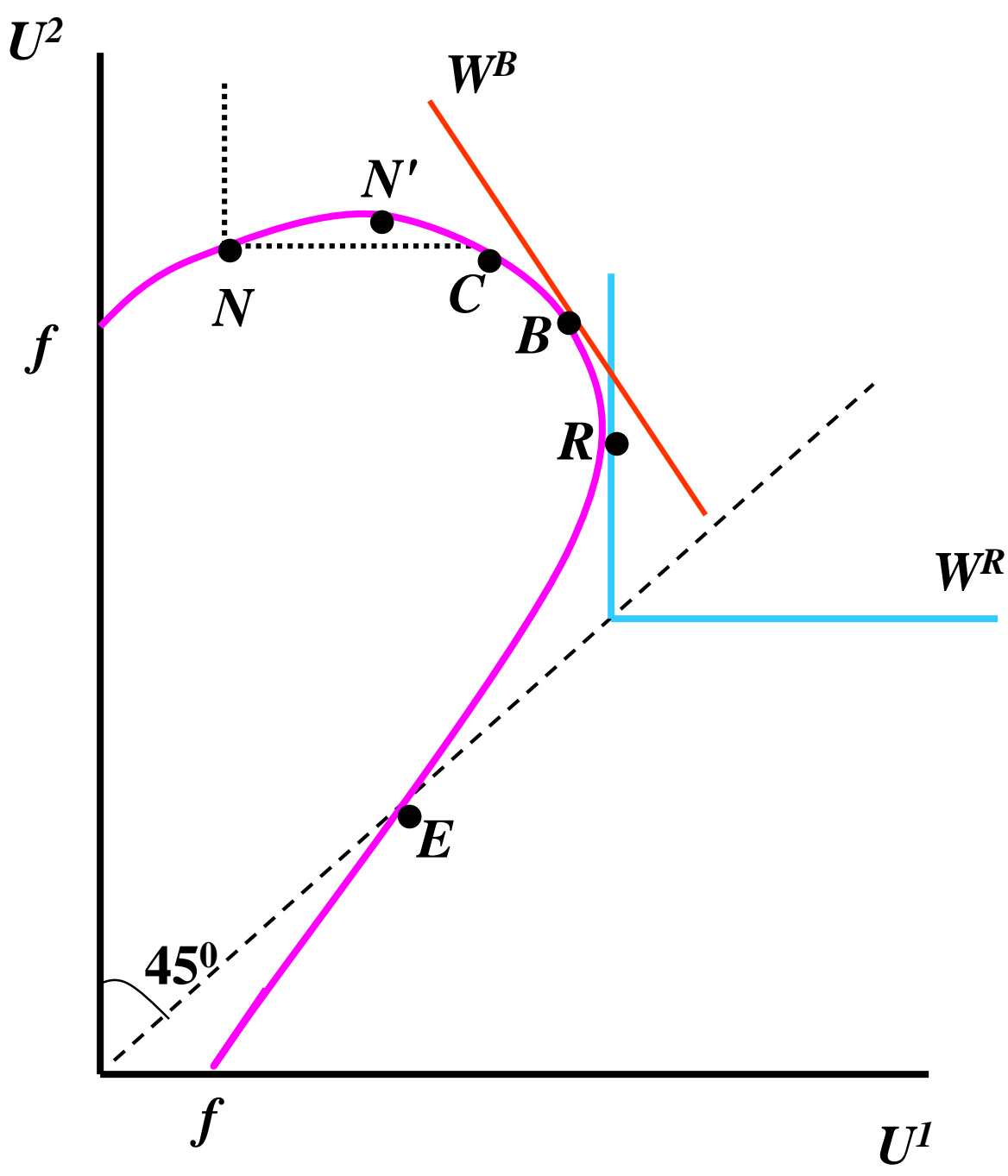
Figure 2: Rawlsian

- **Rawls thought a "just" economy was one where the welfare of the worst-off is as large as possible:**

$$W = \min[U^1, ..., U^H]$$

Social welfare identified with utility of worst-off household(s), $H = 1, ..., H$, i.e., maximization of minimum value of utility vector

Figure 3: Comparison of Welfare Distributions

- **Suppose *ff* is utility feasibility frontier, given policy instruments, e.g., taxes, at government's disposal**

- ***N* – minimal, "night-watchman" state, given initial endowments**

- ***N′* is alternative starting point where no Pareto improvement is possible**

- ***NC* – any move along section is Pareto-improving (contractarian solution) – problem: cannot pick between points along section**

- ***E* – egalitarian solution**

- ***B* – Benthamite/utilitarian solution**

- ***R* – Rawlsian solution**