American Economic Review: Papers & Proceedings 2011, 101:3, 157–161
http://www.aeaweb.org/articles.php?doi=10.1257/aer.101.3.157

ECONOMICS AS A MORAL SCIENCE

The Restoration of Welfare Economics

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This paper argues that welfare economics should be restored to a prominent place on the agenda of economists and should occupy a central role in the teaching of economics. Economists should provide justification for the ethical criteria underlying welfare statements, and these criteria require constant reevaluation in the light of developments in economic analysis and in moral philosophy. Economists need to be more explicit about the relation between welfare criteria and the objectives of governments, policymakers and individual citizens. Moreover, such a restoration of welfare economics should be accompanied by consideration of the adoption of ethical guidelines for the economics profession.

I. Welfare Economics and Welfare Statements in Economics

In his *Foundations of Economic Analysis*, Paul A. Samuelson explained how he disagreed with the celebrated critique of welfare economics by Lionel Robbins (1932):

> "Robbins is undoubtedly correct … ethical conclusions cannot be derived in the same way that scientific hypotheses are inferred or verified. But it is not valid to conclude from this that there is no room [for welfare economics]. It is a legitimate exercise of economic analysis to examine the consequences of various value judgments" (Samuelson 1947, 220).

The main thrust of this paper is that welfare economics is not only a legitimate exercise, but that it is an exercise to which economists should devote more time and attention. As Keynes said, "economics is essentially a moral science" (in a letter to Sir Roy Harrod; see Richard Wright 1989, 473).

When Samuelson wrote, welfare economics was a central concern of the discipline. The survey of "Welfare Economics, 1939–59" by Edward J. Mishan (1960) referenced more than 60 articles on the theory of welfare criteria, with titles such as "Welfare propositions in economics" and "The foundations of welfare economics." As it was put by Kenneth J. Arrow and Tibor Scitovsky in their Introduction to *Readings in Welfare Economics*, "welfare economics has greatly increased in importance.…Economists want to know exactly what they are after, what is the meaning, the limitations, and the importance of economic efficiency and economic progress" (1969, 1).

Today, in contrast, there are relatively few journal articles on welfare criteria. For example, the 2009 volume of the *American Economic Review* contained, in the regular issues, some 65 articles, totaling more than 1,750 pages, but not one dealt with welfare criteria or the foundations of welfare judgments. There are few textbooks written specifically on "welfare economics," and few departments offer courses on the subject. In many places, welfare economics has been incorporated into microeconomics courses or courses on general equilibrium. While welfare economics, as such, was a subject of importance half a century ago, now it has largely disappeared from the mainstream (Anthony B. Atkinson 2001 and 2009).

This does not mean that economists have stopped making welfare propositions. Of the 65 articles in the 2009 volume, no fewer than 20 contained welfare analyses. The titles are instructive: two included the word "optimal," four included "efficiency," and one referred to

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"welfare costs." One asked in its title an explicitly normative question.

Articles reaching normative conclusions typically spend little time justifying the ethical basis for such judgments. A typical procedure is to state the form of the social welfare function, such as the expected sum of lifetime utilities, and then move on to a much more detailed description of the economic model. Little or no justification is given for the choice of the particular social welfare function. In only a few cases are any alternatives analyzed or account taken of ethical criteria not captured by the posited social welfare function. There is little consideration as to how advances in economic analysis may have raised new issues in evaluation.

There are of course notable exceptions. Among the 20 articles cited above, that by Raj Chetty, Adam Looney, and Kory Kroft (2009) recognizes the potential problem for welfare economics of the finding that people may base their decisions on misperceptions of the prices they face. They draw on the important recent work of B. Douglas Bernheim (2009) and Bernheim and Antonio Rangel (2009) examining the implications for welfare economics of nonstandard models of choice developed in recent literature on behavioral economics (and earlier by Amartya Sen 1977). It is precisely this kind of discussion that I would like to see more central to our teaching and research.

But how have economists in general avoided welfare economics?

II. Avoidance Strategies

There are several ways in which the neglect of welfare economics can be rationalized.

The first avoidance strategy is to assume away differences in all relevant economic interests. Many macroeconomic models are populated by identical households, described as "representative agents." It is then assumed that changes in social welfare can be judged simply according to whether the representative household is better or worse off. But this requires justification. Even if everyone were identical, there might be reasons why social judgments go beyond what enters individual utility. As is remarked by Samuelson, "one does not have to be a John Donne … to find fault with the above assumption" (1947, 224). For example, we may believe, as a society, that there are merits in a higher level of overall education than that chosen. An educated society may be able to operate more effectively as a democracy.

But, even if we stay within the framework of strictly individualistic welfare, it is certainly constraining to assume that everyone has the same interests. In most real-world policy decisions, there are conflicting interests. The assumption of a single representative agent may suffice for modeling macroeconomic behavior, but it rules out most interesting welfare economic problems. For example, in debates about labor market reform, there are differing interests for workers in established jobs and those who are outsiders. It would not be possible to discuss the desirability of such reforms without recognizing these different interests. In the debate about pensions, there are conflicting interests of different generations.

This last example brings us indeed to the unavoidable fact that people are born at different dates. All members of a birth cohort may be identical, but their consumption inevitably occurs, at least in part, at a different date from that of their parents. The typical answer to this question is that intertemporal differences are subsumed in a dynastic utility function, which takes account of all future consumption. It is assumed that those present today take into account the interests of succeeding generations. This answer is not easily explained to noneconomists. Since there is often more than one adult generation of a dynasty, they may reasonably ask—*whose* dynastic welfare function? Are we saying to 50-year-olds that their welfare is judged by their 75-year-old parents?

The second strategy does not seek to assume away differences between people. It is assumed instead that there is agreement on the welfare criterion to be applied. Judging by the 20 articles cited above, economists today still largely follow Robbins, who in 1938 said that "my own attitude to problems of political action has always been one of what I may call provisional utilitarianism" (1938, 635). The Presidential Address to this Association of Robert E. Lucas Jr., given 65 years later, stated that

> "To evaluate the effects of policy change on many different consumers, we can calculate welfare gains (perhaps losses, for some) for all of them, one at a time, and add the needed compensations to obtain the welfare gain for the group" (Lucas 2003, 1–2).

Lucas appears to regard this statement as self-evident: he describes it as "the general logic of quantitative welfare analysis" (1). However, this statement disregards the many objections that have been raised to the utilitarian approach. (I am leaving on one side the issue of comparability and of the definition of money-metric utility.) For instance, we may not be content to add the welfare gains: the sum takes no account of how the utilities are distributed. As it was put by Sen, "maximizing the sum of individual utilities is supremely unconcerned with the interpersonal distribution of that sum" (1973, 16).

The more fundamental difficulty with this approach is that it fails to recognize that there are plurality and diversity in the welfare criteria that could be applied. *Plurality* refers to the fact that a single person may bring to bear more than one set of welfare criteria. A person may, for example, be concerned with the greatest happiness, but also with personal liberty. Both are legitimate concerns. They may point in the same direction, but they can also conflict. *Diversity* refers to the fact that different people hold different sets of values. One may be concerned with personal liberty and another person with social justice. Where there are multiple welfare criteria, it makes no sense to talk about *the* welfare consequences; instead we have to apply multiple criteria and consider how conflicts can be resolved.

In particular, welfare economics needs to take account of the alternatives to utilitarianism that have been advanced in the past half century, such as the theory of justice of John Rawls (1971) and the concept of capabilities introduced by Sen (see, for example, 1999). These theories are complex and, in their application to economic policy problems, have been grossly simplified by economists, myself included. When the work of Rawls was first discussed by public finance economists in the early 1970s, we tended to pay more attention to his difference principle than to his first, and lexically prior, principle of basic liberties. The difference principle requires that inequalities in a society should work to the greatest benefit of the least advantaged. This appealed to economists, since they could see the Rawlsian principle as a limiting case of giving more weight to those less well off in a Bergson-Samuelson social welfare function. But this ignored the fact that Rawls was concerned with the distribution of what he called primary goods, rather than with the distribution of individual welfare. In the same way, Sen was concerned to change the evaluative space—in his case to the consideration of individual capabilities, or the freedom that people have to function in key dimensions.

Whatever one thinks of the merits of the alternatives to utilitarianism, one has to ask—when making statements about public policy—how adoption of a different view from utilitarianism would affect the conclusions reached. Where people disagree about the desirability of a particular policy reform, is it possible that they do so because they are motivated by a different view of the objectives of society?

The third avoidance strategy takes the form of an assumed division of labor, with economists taking responsibility for the identification of the possibility frontier and leaving to others the criteria for choosing from that menu. But we have then to ask—who are the "others," and can we really separate the two stages? Answers to the first question are at best implicit in most welfare analyses. Insofar as much of the economics literature appears to be based on classical utilitarianism, the natural reference point may be moral philosophy. The division of labor is then between the economics department and the philosophy department. However, many economists are clearly addressing policymakers, governments, and international organizations. If that is the case, then the criteria should presumably reflect those of these decision makers. However, there is a problem of communication. It is not evident that the typical decision maker would recognize the social welfare functions employed, still less accept them as embodying all their concerns. This becomes even more the case where the objectives are supposed to be those espoused by individual citizens. To give just one example, considerations of "fairness" are commonly raised in popular debates about taxation, which may suggest that economists should pay this more attention, specifically to horizontal equity as a criterion, and, more generally, to theories of fairness (see, for example, Marc Fleurbaey 2008).

Nor is it easy to separate objectives and the constraint set. I give just one example. Suppose that individuals recognize their own interests but are also guided by a personal set of moral principles that lead them to have concern for the less fortunate. The opening sentence in Adam

Smith's *The Theory of Moral Sentiments* begins "How selfish soever man be supposed, there are evidently some principles in his nature, which interest him in the fortune of others" (1759, location 54–61). If such principles lead people to make charitable transfers, then this affects their consumption (and possibly labor supply) decisions and tax revenue. The existence of such "principled" behavior has to be taken into account by the economist in estimating the possibility frontier. But we have also to ask how the individual principles and individual redistribution should enter the social evaluation. It has been argued that it would be double counting to count the "warm glow" to the donor as well as the benefit to the recipients, but it does not seem defensible to ignore totally the altruistic objectives of individuals.

The reference to personal moral principles brings me to the last point of the paper.

III. Ethical Guidelines for the Profession

In seeking to restore welfare economics to a prominent position in research and teaching, I am not arguing for a simple return to the status quo ex ante. I am not suggesting that we rehash the sterile—and often misconceived—debates about compensation tests. I believe that the return of welfare economics will open up new avenues. In the previous sections, I have pointed to some of the questions that should be on the twenty-first century agenda: the implications of behavioral economics, consideration of primary goods and capabilities, plurality of criteria, fairness, and the role of individual ethical codes.

In this final section, I want, however, to raise a further field where economists need to engage with moral considerations. This concerns the behavior of economists themselves, an aspect about which they are uncharacteristically shy. Economists are, in my view, insufficiently reflective about their professional role.

Economists are important actors in the economy, but their activities are not typically modeled. Political economy studies the actions of politicians, government officials, voters, pressure groups, but usually allows no role for economists, either as advisers, or as officials, or as public commentators. Yet in their teaching, research, and public pronouncements, whether about financial markets or about poverty, economists influence economic behavior and the decisions of governments. Just as with other actors, one has to ask what governs the economist acting in a professional capacity. What form does self-interest take in this context? How far is their behavior governed by a set of principles?

In their influence, economists are no different from several other professions. These other professions tend, however, to have established guidelines for good practice. They engage in self-regulation. The American Statistical Association, for example, has set out *Ethical Guidelines for Statistical Practice* covering responsibilities in publications and testimony, and towards funders, research colleagues, the profession, and to the wider public. It summarizes the purposes as follows:

> "to encourage ethical and effective statistical work in morally conducive working environments. … that all statistical practitioners recognize their potential impact on the broader society and the attendant ethical obligations to perform their work responsibly" (Web site of American Statistical Association).

In my view, economists should consider adopting such an approach and adding the study of professional ethics to the training of economists. Guidelines may only systematize what is already regarded tacitly in the profession as good practice, but they would serve to reassure students, and the general public, as to what could be expected of a "moral science."

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