

WELFARE ECONOMICS IN AN IMPASSE? SOME OBSERVATIONS ON MISHAN'S VISION**

BY

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During the past decades no one has written more prolifically about welfare economics than Professor Mishan. A substantial part of his contributions has appeared in the professional journals. In 1964 five of these were published in book form; in the second edition of 1969 this number was doubled (*Welfare Economics. Ten Introductory Essays*). Mishan now presents, in a large-sized volume of two-column pages, a bigger but still selective collection of 22 essays, some of which appear here for the first time. The others date from 1957 to 1979 and are reprinted without alteration. So their historical authenticity has been preserved, but particularly with regard to the older articles a postscript commenting on subsequent developments might have been useful.

Eight essays deal with the difficulties and paradoxes, much discussed in the 1950's and 1960's, pertaining to the fundamental welfare criteria, and with the concepts of economic rent or surplus. At the time of their appearance they did much to elucidate often abstruse debates. Their purport is partly negative, as for instance the essay dismissing the notion of producer's surplus as 'misleading and otiose.' A searching examination exposes the attempts, starting with Ramsey, to construct an economic criterion for intergenerational equity as misconceived. After careful consideration Little's dual welfare criterion is also rejected. The social welfare function, only lightly touched upon, is denounced as an 'ineffectual excrescence on the body of welfare economics.'

On the whole, however, these papers reflect a positive attitude to welfare economics in a period when scepticism about its viability was widely diffused. Recognising its weaknesses, Mishan defends it on several occasions against

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** Review of E.J. Mishan, *Economic Efficiency and Social Welfare*, Selected Essays on Fundamental Aspects of the Economic Theory of Social Welfare, George Allen and Unwin, London, 1981. Pp. 280. £ 22.95.

destructive arguments. Admitting, *e.g.*, that hypothetical compensation is 'an untrustworthy concept' he holds that nonetheless it will as a rule prove serviceable in partial analysis. In a noteworthy constructive effort he salvages to a considerable extent the practical significance of the optimum conditions from the seemingly devastating implications of the second-best theorem. The much disputed consumer's surplus, 'basically a straightforward matter,' is vindicated, together with its twin economic rent, as an operationally valid tool if interpreted in the sense of Hicks's compensating or his equivalent variation (which are assumed to be normally equal).

A further series, occupying about half of the book, is devoted to Mishan's later favourite subjects, externalities and cost-benefit analysis. Here one finds, to mention only some of the special themes, an astute solution, based on the Pareto criterion, for the evaluation of 'limb and life'; the well-known and skilfully argued thesis that in the case of negative externalities the optimum allocation will vary according to whether the law permits them freely or on the condition that the victims have a right to be compensated; the determination of the optimal amount of pollution if different methods of abatement are used together; and some conundrums relating to investment criteria. In the section on cost-benefit analysis methodological questions figure prominently.

The last section contains, next to reflections on the state of welfare economics, more philosophical considerations bearing on social welfare. Among these chapters a lengthy and thoughtful 'inquiry into the economic doctrines of the Chicago school,' mainly its advocacy of the free market, will particularly appeal to a wider audience than welfare economists. Mishan arrives at the conclusion that this school 'has, perhaps, been overimpressed' by the economic and political virtues of the market. He is inclined to expect, not without regret, a continued expansion of government control over the economy. It is gratifying that their disagreement did not prevent Mishan from dedicating the book to Milton Friedman 'with affection and respect.' His volume ends in deep gloom. The final chapter, not published previously, recites once again the dire consequences Mishan is wont to impute to economic growth. In a passage taken literally from *The Economic Growth Debate* (1977) he repeats the lament that there is no room for 'even qualified optimism.' So, in the publication the two sides of Mishan as a writer are represented: the dispassionate theoretician as well as the crusading moralist and social philosopher.

In the theoretical disquisitions great attention is paid to conceptual problems; a notable example is the valuable survey of the postwar literature

on externalities (1971). One encounters much sustained subtle reasoning, there are a sizeable number of sometimes intricate diagrams, but for the rest mathematics is sparsely used; some elaborations are relegated to notes or an appendix. Throughout the author displays, as in his other writings on welfare economics, a firm grasp of the matter under discussion, a thorough knowledge of the literature, a distinct analytical ability, a critical and independent mind, at times disposed to be a bit opinionated, a gift of lucid exposition and a remarkable didactic talent. The potential reader, expecting competent, not unduly technical instruction, will not be disappointed. Still, he may like to know that the gist of what is offered here is for a large part also available, occasionally verbatim, in Mishan's recent bulky textbook *Introduction to Normative Economics* (1981). He may prefer this more succinct and consecutive treatment, without the frequent rather irksome overlapping of the collected essays, though he will miss some refinements as well as the copious notes with many comments on the views of others. It is a pity that the index leaves something to be desired.

To the reviewer the most intriguing feature of the volume is Mishan's ideas about the function of welfare economics, dispersed, more or less fully developed, throughout the book. In many places he appears as a strict Paretian. He steadfastly upholds the Pareto criterion as the only economically justifiable measure for allocative propositions, applies it himself to a large variety of problems and criticises other methods of evaluating welfare effects. He does not tire of insisting that individual preferences, also when misinformed or shortsighted, are the final touchstone in welfare judgments; this imperative is 'the singular characteristic of the economist's method.' Accordingly, he strongly opposes the introduction of political parameters, like the adoption of a politically determined social rate of time preference and, in particular, the use of distributional weights, reflecting the preferences of decision-makers, in cost-benefit analysis. No inconsistency is involved, of course, by his pointing out limitations of the Pareto criterion, such as its failure to provide a determinate solution if various compensation tests produce contradictory outcomes, and its restricted applicability to long-lived investment projects.

However, the Paretian propriety of another reservation is dubious. In one respect Mishan departs from the forcefully proclaimed inviolability of individual preferences, namely by excluding from consideration envy and pleasure at the misfortune of others which give rise to what he calls illegitimate external effects. Inclinations of this kind have been incorporated in various Paretian models and Sen, in his critique of 'Paretianism,' likewise presumes that it takes the utility yielded by the discomfiture of others and even by

torture into account.¹

Mishan's contrary opinion is connected with, yet not wholly representative of his conception of welfare economics. Like most others in the field he is convinced that it is a normative discipline; as he puts it, the allocative rules are 'ought statements that rest upon value judgments.' He has evolved a distinctive version of this interpretation, briefly sketched in his De Vries Lectures (*Welfare Economics: An assessment*, 1969) and repeatedly expounded in the collected articles. Its characteristic contention is that the normative validity of welfare theory depends on the condition that its ethical premises are sanctioned by a consensus or at least widely held beliefs in the society to which its prescriptions are addressed. In Mishan's presentation the 'basic maxims' are twofold, to wit that individual preferences must be respected (justified by the admittedly not entirely truthful assumption that everyone knows his own interest best) and that Pareto improvements, real or potential, are desirable. It is because the utility or disutility derived from malice, envy and the like will not be favoured by society's ethics that Mishan wants to discard them from welfare judgments. This adaptation of the ethical presuppositions remains, however, a case apart in his set-up. Otherwise, if they conflict with prevailing beliefs they are maintained but the propositions based upon them will in practice be superseded. This position, left unexplained by Mishan, is presumably chosen to avert the impairment of the generality and integrity of welfare economics by endless casuistry.

In view of the ethical character Mishan ascribes to welfare economics it is most peculiar that he stresses again and again that the Pareto criterion and the results obtained by it are 'purely economic.' This evidently inconsequent expression is used to signify that the premises of welfare economics are typical of the economist's method and, principally, that the theory based on them is independent of the political will or the political process, so that the welfare economist is not a mere technician or consultant, subservient to goals set by politicians.

Mishan's explanation of the normative status of welfare economics raises the crucial question of to what extent its ethical axioms are in fact sanctioned by society. On this issue Mishan offers numerous observations and some more extended discussions. These assessments are not free from inconsistencies and at times reflect his own predilections. Not surprisingly, his appraisal shows that society's approval of the value judgments on which welfare

1 A.K. Sen, 'Personal Utilities and Public Judgments: or What's Wrong with Welfare Economics?,' *Economic Journal*, 1979, pp. 549ff. Also in K.W. Roskamp (ed.), *Public Choice and Public Finance*, Paris, 1980.

economics is held to rest is subject to serious qualification. Recording the notorious fact that consumers' sovereignty is not generally respected, Mishan adds grumbles of his own concerning the trivial tastes current in modern society. On the Pareto criterion the verdict is ambiguous. Mishan asserts, with a degree of optimism that will not be universally shared, that 'there can be little doubt about actual Pareto improvements being ethically acceptable to society' (p. 259, though this statement seems to be contradicted on p. 263). Against this, the 'ethical appeal' of potential improvements, to which practical allocative propositions mostly refer, is judged to be 'limited' (also 'not convincing' and 'not compelling'). Although he does not deny the possibility that under certain specified conditions this criterion may be approved by society, he warns that if a cost-benefit analysis indicates a potential Pareto improvement this should not be interpreted as a decision criterion. Obviously, the main obstacle to the unconditional acceptance of the Pareto criterion, especially if it relates to potential improvements, lies in its distributional implications.

Mishan is surely right to infer that the allocative prescriptions of welfare economics do not have a claim to priority in political decision-making. It is remarkable that he even deplores the priority given by economists to the allocative aspects of economic policy and rebukes them, apparently overestimating their influence, for the social damage they have perpetrated by so doing. On the other hand he contrasts, one might think rather too sharply, a good allocation to a chaotic one, scarcely an attractive alternative. These are not the only signs of a certain ambivalence. Once he seems to condemn his whole enterprise to failure from the start by stating that 'the individual's goal of maximising utility has little ethical appeal.'

After the gradual demolition of a good deal of the normative capacity of welfare economics the reader is in for a still more dramatic dénouement. In the penultimate chapter, not published elsewhere, Mishan argues that in the modern growth economy 'the consensus necessary for a normative allocation economics is dissolving.' As a consequence, at least in the West, welfare economics is losing its *raison d'être*; the normative economist, one more victim of economic growth, 'can no longer speak with authority.' All the same, Mishan shrinks from jettisoning the subject, in the hope of better times to come or its possible usefulness elsewhere. Contrariwise, the publication of the textbook mentioned above, where the alarmist diagnosis is not even alluded to, evinces a much more hopeful mood. This contrast leaves one wondering what Mishan's actual position may be.

Mishan's attempt to clarify and evaluate the normative validity of welfare economics deserves appreciation. It compares favourably with the customary

practice of positing its ethical purpose as a matter of course and also with the explicit but essentially tautological defence of this view by Blaug in his recent book on economic methodology. To counter what he calls the Archibald–Hennipman argument in support of a positive interpretation he resorts to the *petitio principii* that this is paradoxical because ‘welfare economics is, after all, that branch of economics concerned with the ethical criteria by which we decide that one economic state of the world is more desirable than another.’² This assertion is, of course, just the point in dispute.

Ironically, Mishan’s endeavour to establish normative welfare economics on a more solid base turns out to disclose unmistakably the emptiness of any ethical pretence. Its manifest inherent inability to furnish mandatory prescriptions proves to be of a different order altogether than the fact that every moral rule is liable to exemptions in special circumscribed situations or the possibility that equally important ethical values may clash. The futility of the claim to ethical worth is not solely due to the erosion of the consensus Mishan attributes to economic growth, but this epilogue may be seen as a *reductio ad absurdum* of his argument and, presumably, of normative welfare economics in general.

The logical and simple way out of the quandary in which this conception finds itself is to regard welfare theory as an ethically neutral subject. Thus emancipated from embarrassing presumptions it is really ‘purely economic.’ Confusion is avoided by distinguishing clearly between instrumental economic and ethical judgments. As Sowell puts it tersely: ‘Economic Optimality is not moral justification.’³

An advantage of this view is that it eliminates a number of otiose complications and puzzles on which a good deal of ingenuity has been spent. The artificial assumption that everyone knows his own interest best can be scrapped. Also, contrary to Sen’s assertion, which created quite a stir,⁴ it appears to be perfectly possible to be that alleged nonperson, a Paretian liberal.⁵ His agonising question ‘what’s wrong with welfare economics?’ finds the ready answer that it is naturally unable to perform adequately the gratuitously self-imposed duty to issue ethical directives. The neutral theory does not

2 M. Blaug, *The Methodology of Economics*, Cambridge etc., 1980, p. 146.

3 Th. Sowell, *Knowledge and Decisions*, New York, 1981, p. 75.

4 ‘The Impossibility of a Paretian Liberal,’ *Journal of Political Economy*, January–February 1970; also in F. Hahn and M. Hollis (eds.), *Philosophy and Economic Theory*, Oxford, 1979.

5 This is exemplified by Yew-Kwang Ng, *Welfare Economics*, London, 1979, who regards welfare economics as a positive study (pp. 2ff.) and professes (p. 138) to be the kind of liberal ruled out by Sen.

a priori banish ignoble satisfactions from its scope, however appropriate it may appear to deny them positive value in an ethical system of thought like Harsanyi's rule utilitarianism. Yet it can be conceded to Mishan that they might be disregarded in some practical applications. In addition, it may be remarked that Mishan's ethical consensus should not be equated with the Wicksellian unanimity rule; the latter refers to arrangements economically advantageous to all parties. Mishan does not mention it, generally showing little interest in the theory of public choice.

It is an astounding misapprehension that if welfare economics is conceived in a neutral sense it will be reduced to what Mishan calls 'a private game for connoisseurs.' It is easy to see that the selfsame insights presented in a more modest form are not one iota less useful. As a matter of fact in this shape its prospects look brighter than Mishan fears. Its credibility, still shaky in some and even high quarters, as Lord Robbins's adverse comments testify,⁶ will be enhanced. Its practical relevance is not dependent on an elusive ethical consensus but, like all economic knowledge, on manifold ever-changing economic, social, ideological and political factors. It does not aspire to the privileged position with relation to economic policy which Mishan grants it. The distinction he likes to make (with a not entirely fair reference to Tinbergen, whose contribution to welfare economics he ignores) between the independent welfare economist and menial advisers engaged on other problems is highly disputable.

It is a laudable step forward that Mishan does not declare, as is often done, that neutral welfare economics is 'impossible,' but he deems it only worthy of a few meagre paragraphs. Actually, in some passages he comes very near to accepting it implicitly, *e.g.* when he characterises the outcome of a cost-benefit study as just 'one of the essential bits of information' needed for a decision, and several times in the account of the present predicament of welfare economics. From this it would be a mere step further to acknowledge expressly the conclusion that emerges from his own inquiry.

Fortunately, despite the objections his fundamental tenets and possibly some opinions on special topics or matters of detail elicit, there is no reason to close this review on a note as depressing as the ending of Mishan's volume. Seen as a whole, the work comprises a rich and distinguished collection, bringing much enlightenment and conducive to fruitful discussion.

6 'Economics and Political Economy,' *American Economic Review*, May 1981, pp. 4ff. Robbins calls the Pareto criterion 'clearly a judgement of value' and the claims of welfare economics to be scientific 'highly dubious.'

*Summary*WELFARE ECONOMICS IN AN IMPASSE?
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This review of a collection of Mishan's essays on welfare economics focusses on his views regarding its function, especially his thesis that the ethical prescriptions which, according to him, it provides, only have normative validity if its basic value judgments conform with the ethical consensus of the society for which they are intended. It appears that this condition is seldom fully satisfied. Moreover, Mishan argues that in the modern growth economy the erosion of a consensus deprives welfare economics of its normative authority. The reviewer concludes from Mishan's reasoning that a neutral interpretation of the subject would be preferable to the ethical one.