# ECONOMICS AS APPLIED ETHICS

## VALUE JUDGEMENTS IN WELFARE ECONOMICS

WILFRED BECKERMAN

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In the Acknowledgements to his latest book, *The Idea of Justice*, Amartya Sen lists about 360 people who have contributed in one way or another to the development of the views expressed in his book. By comparison, my little list of a dozen or so people is rather brief. I would not dream of suggesting that help from another 350 or so people would have made my book any better. But, at least, such little merit – if any – that my book may have has to be shared out among only about a dozen people, not 360! But they, of course, do not share any of the responsibility for all its defects.

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# Introduction

This book is about ethics in economics. It is designed primarily for students who already know quite a lot of economics, but who have not been confronted with the ethical problems implicit in conventional economic analysis. This is rather surprising in a way, for people do not usually come to economics until long after they are confronted with ethical problems in the ordinary course of their lives. In fact, people do not usually start studying economics until their late teens. But we all start 'doing' ethics as small children. When one of my children asked me 'How can I know that I am not still dreaming', I was delighted by this early interest in the area of philosophy known as 'epistemology', and when one of them asked: 'Why don't I get a bigger share of that cake, since I helped to bake it?', I was equally pleased by this precocious interest in distributive justice. (In fact, professional philosophers are just people who go on asking the same questions as children do, but with the aid of a long training in how to avoid answering them.) But the ethical problems that we all encounter at an early age are rarely linked to the economic theory which students of the subject encounter later in life. This book is an attempt to explain the link.

There are sound reasons why standard economics textbooks pay little attention to ethics. For public discussion of alternative economic policies and projects – such as what to do about interest rates, or minimum wages, or building some new road or irrigation installation, or combating man-made climate change, and so on – is invariably focused on only the presumed economic effects of different options. The debate is rarely focused on ethical issues, such as the concept of society's total economic 'welfare', the variety of competing concepts of 'equality', or the status of consumers' sovereignty, or how far a country ought to take account of the welfare of other countries' citizens. And in most cases this is perfectly justified. In most cases the optimal policy – if there is one – depends on an appropriate factual analysis of the likely costs and benefits of the various options. This is because many of the ethical assumptions underlying much economic policy analysis are fairly general, and hence do not depend on the specific facts that are relevant in any situation. One does not have to re-open discussions about the foundations of mathematics every time one wants to calculate the stresses involved in building a bridge. In the same way, there is no point in rehearsing over and over again the pros and cons of different fundamental ethical assumptions every time one is analysing the economic case for building it.

Welfare economics is that part of economic theory that analyses how far the working of an economy contributes to the economic welfare of society and the conditions that have to be satisfied in order to maximize this contribution. The main ethical issues implicit in 'welfare economics' have been well known to economists for many decades. They were forcefully drawn to the attention of the economics profession in the seminal contributions to welfare economics of Abram Bergson and Paul Samuelson in the late 1930s and the 1940s, and then in Ian Little's pioneering book *A Critique of Welfare Economics* in 1951 and J. de V. Graaff's *Theoretical Welfare Economics*, which was largely written in the early 1950s but not published until 1967.[1] And during the last few decades many other distinguished contributions have been made by economists and philosophers, some of which are mentioned at appropriate points in this book.

However, the fact that ethical issues do not need to figure prominently in the analysis of particular practical economic problems does not mean that they are uncontentious and leave no room for disagreement. Far from it, as this book attempts to show. It is simply that, as a rule, it is much more useful to do research into the relevant facts than to re-open fundamental ethical issues.

Another reason why less attention is given to the ethical foundations of economic policy is that most of them show why it is difficult to say how far the economy is *starting* from a position that can be accepted as 'optimal'. They are judgements about how one can define an optimal starting position. But practical policy choices are never about whether the position from which we are starting is optimal. *It never is optimal.* We all know that. And we know it thanks to the basic theory of welfare economics, which establishes the conditions that would have to be satisfied in an optimal starting position, and the ethical assumptions underlying these conditions.

Practical policy choices are about the desirability of alternative *moves* from some actual real-world, 'second-best', starting position. And for this purpose, whether or not the starting position is optimal is of little interest. One is not comparing options with some 'optimal' position. One is trying to evaluate the welfare consequences of feasible moves from whatever position we happen to be starting.[2] The main issues are about the positive consequences of any specific move in some specific direction from some specific starting point. Ethical assumptions have to be made, and in some cases – as will be seen in later chapters – they may be decisive. This is one of the reasons why a conventional comparison of the costs and benefits of any policy can make a major contribution to decision-making only when the gap between expected costs and benefits is substantial and the distributional effects are likely to be negligible. But to know whether these conditions are satisfied usually requires, above all, a better understanding of the facts.

Given the enormous complexity of the economic system and the methodological handicaps to empirical research in the social sciences, it is extremely difficult to establish the relevant facts – rather than the values – required to arrive at policy prescriptions. Progress can only be made painstakingly, in small steps. This applies to both the collection of the data and to the immensely difficult task of processing and analysing them. Such small steps do not attract big headlines. They are far less exciting and crowd-pleasing than grand assertions about the alleged failure of economists to allow for human nature, or some such cliché that many people who know nothing about economics like to repeat. Over the course of their lives most economists will have met people who, when told that they were economists, would say, 'Ah, but what you economists always forget is ... blah, blah, blah ... *homo economicus* ... blah, blah, blah'. My personal experience is that when anybody begins a conversation that way it soon becomes clear that he or she does not know what economists remember. It is simply that economists do not find it necessary to keep banging on about the assumptions that are safely tucked away in the recesses of their memories.

Nevertheless, although – for the reasons given above – the value judgements inherent in welfare economics are not prominent in economic research or education, students of the subject, or politicians, ought not to be left with the impression that economics is a value-free objective science. Economics is supposed to be about the way that the economy can make an improvement in that part of people's welfare that has economic causes. But everybody can have his or her own idea of what 'welfare' consists in. There are innumerable ways that a person's welfare can be promoted, such as better personal relationships, increased knowledge and skill, relief of poverty, improved health, and improvements in the society around him or her, such as greater peace or tolerance. Aristotle believed that ethics was an applied science (though he emphasized that it was inevitably less precise than other sciences). It was the science of how an *individual* should live in order to promote his or her welfare – or, rather, Aristotle's concept of it! Most forms of economic activity can also contribute to people's welfare, directly or indirectly, in some of the ways listed above. So, if ethics is the science of raising people's welfare, economics is part of it. It is that part which is about the way the economy can raise people's welfare. This requires some assumptions about: (i) what constitutes 'welfare'; (ii) how exactly different economic activities contribute to it; and (iii) how different policy choices affect these activities. The study of the last two assumptions is, in principle, a scientific endeavour, and is represented in what is known as 'positive economics'.

This book arose out of a course, to which I have contributed, that has been given by Joanna Pasek on 'Ethics in Applied Economics' in the Economics Department of University College London, which has been designed to plug a gap in conventional economics training. The course aims to teach third-year undergraduates and some graduate students something about the ethical issues that lie behind any economic policy proposals (in spite of Aristotle's view that one cannot teach ethics to young people, since they will lack the experience of life which is necessary to appreciate the subject matter!). I assume that students will be familiar with the basic theory of welfare economics, so I often make reference to it without going into full explanations of the concepts used. Numerous excellent textbooks are available for this purpose. But the teaching of welfare economics and the related micro-economic theory does not usually leave room for any discussion of the ethical issues that are involved. There is enough work to be done to explain the basic positive economics theory – which has become increasingly sophisticated and complex over time – of how far the economic system works without having to take on board, at the same time, its ethical underpinnings. In this book I try to remedy this omission.

For the same reason, I have not attempted to cover the interesting contributions to the ethics of economic policy that have been made in various specialized spheres of economics, such as environmental economics, feminist economics, development economics, and so on. Students interested in these particular fields of economics should address themselves to the relevant specialized literature.

With a few exceptions – such as students who are taking a joint degree in economics and philosophy – most economics students would not necessarily know anything about basic philosophical concepts. Consequently, the first two chapters of this book have been devoted to explaining these concepts. This means that they will seem terribly elementary and oversimplified to anybody with a good philosophical background. And throughout the book the treatment of the ethical topics discussed has been very summary. My main objective is *not* to write a book about ethics but to show how ethical assumptions have to be made at each stage in the construction of the standard welfare economics models. The book has been written chiefly for students of economics. As long as readers of this book finish up being more conscious of the different value judgements that enter into welfare economics, and, in particular, its practical application in cost–benefit analysis, it will have served its purpose. If they wish to pursue further the philosophical problems involved, ample references are given to the relevant literature.

Among this literature pride of place has to be given, of course, to the works of John Broome, Partha Dasgupta, Ian Little and Amartya Sen, who are all masters of both the economics and the philosophy relevant to economic theory and applied economics. I could not have written this book without the guidance that their work has provided. All of them would have been able to write a far better book, of course, but their comparative advantage has been to push outwards the frontier of our knowledge.[3] My old friend and ex-colleague Paul Streeten once said to me that the function of most economists is not to push the frontier of knowledge outwards but to try to stop people from operating too far inside it. These economist/philosophers have always managed to do both, but – fortunately – have concentrated on where their comparative advantage lies.

As indicated above, the book begins with some explanation of certain basic philosophical concepts. This is followed by an explanation, in general terms, of the role that value judgements play in the framework of welfare economics, including the concepts of Pareto optimality and the social welfare function. This leads to a more detailed discussion of a few selected major issues in economic policy. The chief one, perhaps, is equality and distributional justice. So two chapters are devoted to these problems.

A further increasingly important issue in the light of increasing globalization and the emergence of global environmental problems is the question of how widely we draw the boundary of the society with whose economic welfare we are concerned. This is chiefly a problem in political philosophy, since welfare economics is addressed to the maximization of the economic welfare of whatever society we wish to choose. But what society ought we to choose? This is an ethical question. Hence, it cannot be ignored in the context of the many important topical economic problems that involve international or intergenerational concerns. Consequently, specific chapters have been devoted to the boundaries of society across space and across time – i.e. distributive justice between nations and generations.

Because the boundary in time has become so important lately on account of environmental developments, particularly climate change, I also devote a separate chapter to the problem of discounting the future, which lies at the heart of climate change policy. Another specific problem to which a separate chapter is devoted is the valuation of life, which enters into many policy issues, such as the appropriate size of expenditures on the health services, transport or the environment, not to mention the possible consequences of atmospheric pollution. The closing chapter of the book consists of a rapid recapitulation of the main value judgements that I have identified at various points as important in applied welfare economics.

At many points in the book I refer to an apparent difference between standard economic reasoning and ethical reasoning. In applied economics, once the relevant 'facts' in any situation are established – albeit with different degrees of uncertainty – they can be plugged into some generally accepted theoretical model and an answer as to what effects are likely to follow from what causes can be ground out. Ethics is not like that. An important preoccupation of ethical theory is how far one can identify conflicting ethical intuitions and how far it may be possible to resolve the conflicts by bringing them into some consistent analytical framework. Hence, at various points in this book attention is drawn to the role, in economic policy, of ethical intuitions that conflict in ways which cannot easily be resolved in the economist-friendly manner of an appeal to an established analytical framework and the optimizing criteria that can be derived from it. True, some ethical 'systems' purport to provide the necessary generality. These would include utilitarianism, Kantianism and, perhaps, some religious systems. But the problems to which they give rise have been the subject of a vast amount of literature and debate, and there will be occasion to mention some of their main features at appropriate points in this book. Many eminent philosophers believe, or have believed, that there is some general 'system' within which apparently conflicting intuitions can be incorporated and the conflicts resolved. I should be so lucky!

Chapter 1

# Fact or Value? A Simple Example: Sustainable Development and the Discount Rate

## 1.1 Fact or value? An illustration

A major theme of this book is the mixture of fact and value judgement in the choice of economic policies or projects. This can be illustrated in diagrams 1a through 1c shown in Figure 1.1. These diagrams refer to what may well be one of the most important problems facing the world today. This is the problem of sustainable development, in general, or of climate change in particular.

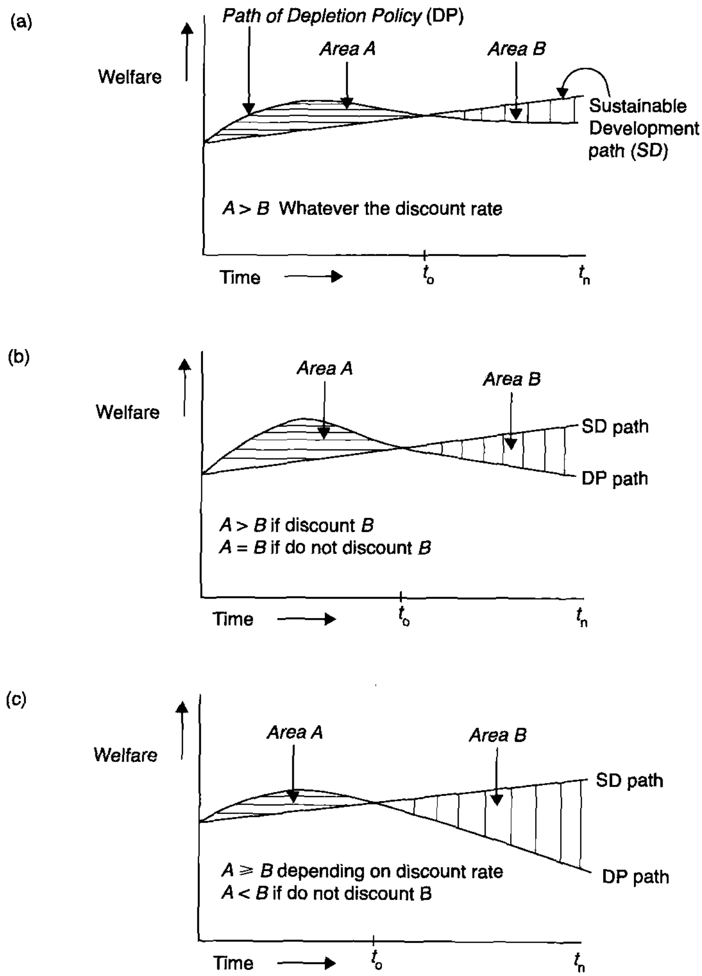
It is widely believed that the rate at which we are using up the Earth's resources, including an atmosphere reasonably uncontaminated by carbon molecules, is piling up terrible problems for future generations. To some economists some of these fears – particularly as regards the exhaustion of raw materials for which no substitute can ever be developed – seem exaggerated, at least for the world as a whole, if not for individual countries. But other fears – notably of global warming as a result of excessive man-made carbon emissions – are backed up by more serious scientific research. Of course, the 'consensus' about climate change may not be as universal or reliable as is widely believed. Over the course of human history scientists often have been wrong. That is the mainspring of progress in science. But I am not concerned here with the scientific pros and cons of the debate about sustainable development or climate change policy. The object here is simply to show how the choice between a policy of sustainable development (including the avoidance of serious climate change) and a policy of 'depletion' (whether of excessive use of natural materials, or emissions of carbon) provides a very simple illustration of the mixture of fact and value judgement in welfare economics and its practical application in cost–benefit analysis.

Economists would approach the choice problem with a model such as that used below, which uses the concept of 'sustainable development'. There are hundreds of definitions of this concept on the market, for very good reasons. For example, over what time period, or under what circumstances, is development to be 'sustainable'? But there is no need to enter into these questions here. Suffice it to say that, in Figure 1.1, the path of sustainable development (SD) represents the path that – it is believed – society could follow without running into problems in the future, such as serious global warming, that would lead to a long-term decline in welfare (e.g. resulting from a fall in *per capita* incomes). And the other path, which is the 'depletion policy' (DP) path, represents the future path of world welfare that can be expected should we fail to pursue the policies that are necessary to prevent dangerous loss of resources or excessive climate change. (To simplify the exposition we shall assume that population is the same under both paths.)

To an economist the 'optimal' path is one that maximizes the cumulative value of the future stream of 'utility', or 'welfare'. It is highly likely, for example, that a depletion policy will mean higher benefits in the short run than would a policy of resource conservation, so that in the short run a depletion path would mean greater welfare than the sustainable development path. But, so the story goes, it is believed that, at some point in the future, economic activity will slow down and the level of welfare under the depletion policy might finish up lower than under the SD policy. The optimal path then will depend on a comparison of the extent to which welfare under the DP policy exceeds the SD policy in the early years with the extent to which it is the other way round in the later years.

The comparison can be illustrated in the following diagrams (Figure 1.1). The horizontal axis in the diagrams represents time, and the vertical axis represents welfare, the units being arbitrary in each case. Similarly, the cut-off point at time $t_n$ is arbitrary and could represent, say, one hundred years into the future or a thousand years in the future. To simplify the exposition, the SD paths in the diagrams are assumed to be the same in each scenario and to be starting from the same point in time. But in the different diagrams different time paths of DP are shown. The area 'A' in each diagram represents the excess of welfare achieved under the DP relative to SD from the starting point up to the (arbitrary) point, $t_0$, where the two paths intersect. The area 'B' in each diagram represents the excess of welfare from time $t_0$ to time $t_n$, if the SD path is followed, over the welfare that would have been achieved if the DP path had been followed. Thus the whole game is how to compare the two areas A and B. If A is greater than B, it might appear that the DP policy is best, and vice versa. Presented like that it might appear that it is a factual issue – or at least an issue concerning *probable* 'facts'. It may be technically impossible to be quite sure which path would result from which policies, but, as long as the objective is to maximize the cumulative welfare over the time period selected, it is clear that one has to try to maximize the *expected* balance of area A over area B. But this is where we have to leave 'facts' and consider 'values'.

**Figure 1.1** ***Sustainable development: balancing fact and value***




## 1.2 Enter the 'values'

There are three main ethical issues that complicate the problem.

1. First, how is 'welfare' to be defined? Everybody is aware that there is scope for a wide variety of views as to what constitutes the welfare of society. Some of these are discussed in more detail in later chapters, so they will be left aside at this point.

2. Second, what about the discount rate? Most people (and public authorities, and private corporations) do not value future costs and benefit as highly as present costs and benefits. They 'discount' them at some rate of interest.