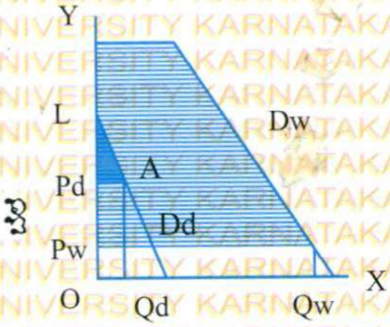
KARNATAKA STATE OPEN UNIVERSITY

Mukthagangotri, Mysore-570 006

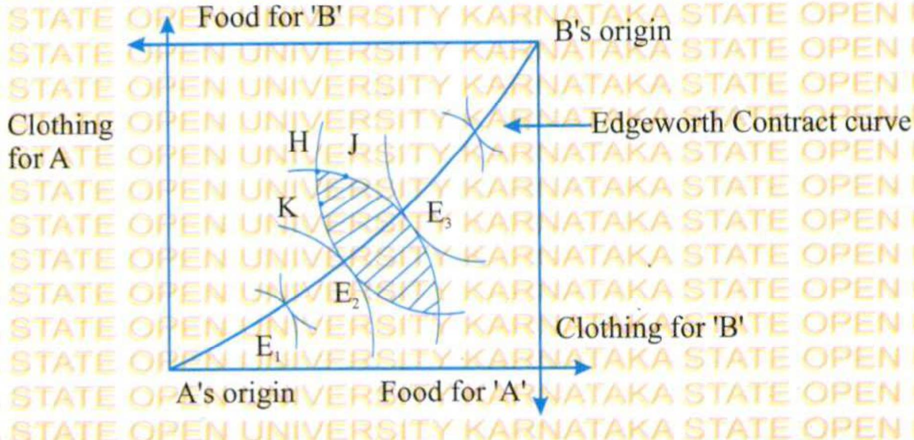
ECONOMICS

M.A. (FINAL)

WELFARE ECONOMICS



ನೀರು - ಬೇಡಿಕೆ Paradox



COURSE - 5 **BLOCK - 1-7**

2

KARNATAKA STATE OPEN UNIVERSITY

MUKTHAGANGOTRI, MYSORE - 570 006.

M.A. ECONOMICS

FINAL

COURSE - X

Welfare Economics

BLOCKS - 1

BLOCKS - 2

BLOCK - 3

BLOCK - 5

Course Design and Editorial Committee

Prof. M.G. Krishnan
Vice-Chancellor & Chairperson
Karnataka State Open University
Mysuru - 570 006

Prof. T.D. Devegowda
(I/C) Dean (Academic) - Convenor
Karnataka State Open University
Mysuru - 570 006

Course - V Block - 1, 2, 3, 5, 6, 7

Dr. S. Shivanna — **Subject Co-ordinator**
Chairperson and Associate Professor
Department of Studies & Research in Economics
Karnataka State Open University
Mysuru - 570 006.

Dr. Bharathi M.R. — **Course Co-ordinator**
Rtd. Professor
Department of Studies & Research in Economics
Karnataka State Open University
Mysuru - 570 006.

Dr. Sridhara Murthy L. — **Course Co-ordinator**
Professor in Economics (Rtd.,)
Maharani's College,
Mysuru - 570 006.

COURSE WRITER BLOCK - 1, 2, 3, 5 & 7

Dr. Bharathi M.R. — **Units 1 - 2, Units 3 - 10**
Rtd. Professor — **Unit 11, Units 15 - 17**
Department of Studies & Research in Economics — **Units 26 - 30**
Karnataka State Open University
Mysuru - 570 006.

COURSE WRITER   BLOCK - 7

Dr. Sridhara Murthy L. **Units 18 - 25**
Professor in Economics (Rtd.,)
Maharani's College,
Mysuru - 570 006.

The Registrar
Karnataka State Open University
Mukthagangothri, Mysuru - 570 006.

Developed by Academic Section, KSOU, Mysuru
Karnataka State Open University,

Further information on the Karnataka State Open University Programmes may be obtained from the University's Office at Mukthagangotri, Mysuru.

Printed and Published on behalf of Karnataka State Open University, Mysuru by

Registrar (Administration)

M.A. ECONOMICS (FINAL)
Course - 10
Welfare Economics
BLOCK - 1 INTRODUCTION

Students are introduced to welfare economics. In this Block there are two units which provide information regarding the nature and scope of welfare Economics and the evolution of Welfare State. In the first unit some definitions and subject matter of Welfare Economics are discussed. It is also analysed that Welfare propositions are not positive, they involve value judgments.

In the second unit, the evolution and functions of welfare states are studied. The Industrial Revolution. Russian Revolution and Great Depression have had impact on the economic policies of the various states. "Welfare State in not an organization like capitalist or Socialist economics. The welfare activities can be carried in all types of economics.

BLOCK - 2 INTRODUCTION

Block 2 deals with pre-Paretian welfare Economics. In this block classical theory of welfare economics is discussed. There are eight Units. In Unit 3 we discuss welfare aspects of the classical theory. Classical theory of value. Trade and economic implications found there in are studied in this Unit.

In Unit 4 Bentham's views on economic welfare are studied. Greatest happiness of greatest number is the principle explained by him. He has tried to measure society's happiness.

Unit-5 deals with welfare implications of individual consumption. Individual welfare condition is studied. The methods of measuring utility are studied. Economic welfare implication and income distribution are studied in Unit 6. Lemer's Views and utilitarian views are expressed.

Unit - 7 deals with Mushallian welfare economic ideas, tax-bounty analysis are studied.

Unit - 8 deals with Compensations principle. Ideas, of Hicks and Kaldor are studied in the unit.

Unit - 9 deals with Compensation variation. It is explained by Hicks.

Unit - 10 deals with the welfare implications in a socialist state.

BLOCK - 3 INTRODUCTION

Block 3 consists of one Unit. It deals with Pareto optimality. Pareto optimality occupies an important place in the literature of Economics. In this block Pareto criterion in studied in detail. Pareto optimum is often called economic efficiency. Pareto criterion in explained with the help of Samuelson's utility possiblity curve. Lerner and Hicks derived the marginal conditions which have to be fulfilled to attain Pareto Optimum. Efficiency of exchange, Efficiency in production, Efficiency in product mix, degree of specialisation are studied in this block 3. Pareto optimality is a very important topic discussed in welfare economics.

Block IV consists of contributions of Barone, Kaldor and Hicks. They are dealt in Block Two. So Units 12, 13 and 14 are omited to avoid repetition.

BLOCK - 5 INTRODUCTION

This block consists of three Units. It deals with contributions of Scitovsky, Samuelson and Burgson. The theory of Arrow is also explained in this block. The block deals with the political aspects of welfare.

Unit 15 explains the views of Scitovsky. He has explained double Criterion to measure welfare.

Unit 16 explains contributions of Samuelson and value judgement in welfare economics.

Arrow's theorem of impossiblity is studied in Unit 17 along with the contributions of Burgson.

BLOCK - 6 INTRODUCTION

Block VI brings out at one place several later developments in the field of welfare economics. These are eight lessons as divided below.

Unit 18 : Pigouvian Welfare economics

Unit 19 : External economies and diseconomies

Unit 20 : Welfare and efficiency

Unit 21 : Theoretical measure of economic welfare

Unit 22 : The empirical measures of economic welfare

Unit 23 : The distribution of economic welfare

Unit 24 : Increasing returns and economic progress

Unit 25 : Interdependent utilities

I have been greatly benefited in terms of availability of relevant literature by searching the web. So, it is time you pick up techniques of search, if not already familiar.

BLOCK - 7 INTRODUCTION

Block 7 is the last block in welfare Economics. It deals with non welfare issues. In Unit 26 the meaning and effects of tariff and the determination of optimum tariff are dealt with. Unit 27 is devoted to discussion of pricing of public utility undertakings, nature of public utilities, and their pricing policies are also discussed. Unit 28 studies the recent developments in welfare economics. Social decision rules to determine social choice and ethical dimension of welfare economics are studied. Utility strategy of William Vikery and Harsany are studied. Unit 29 discusses conceptualizing welfare efficiency relationship. Unit 30 discusses policy implications and future direction. Welfare measures have to evaluate the present and future growth process. Natural resources are conserved to protect future generation. There is a need to develop integrated programmes for taking the case of aging population.

Chairperson

DOSR in Economics

Karnataka State Open University

Mukthagangotri,

Mysuru - 570 006

UNIT - 1 NATURE AND SCOPE OF WELFARE ECONOMICS – I

Structure

1.0 Objectives

1.1 Introduction

1.2 Some definitions of welfare Economics

1.3 Nature of welfare Economics

1.4 Subject matter

1.5 Positive Economics and welfare Economics

1.6 Defining Individual, general and social welfare

1.7 General Welfare and social welfare

1.8 Individual welfare and social welfare

1.9 Value judgement in welfare Economics

1.10 Let us Sum Up

1.11 Some questions

1.12 Books.

1.0 OBJECTIVES

After studying this unit you should be able to explain.

* Maximum Social Welfare.
* Economics is not positive, it makes prescription
* The reason for the use of value judgements in making prescriptions.

1.1 INTRODUCTION

Microeconomic theory deals, with positive aspects. It explains optimum allocation of resources at individual levels. It explains how individual consumers maximize their utility function and firms their profit functions. An analysis of the various aspects of economic theory it may appear that if all individuals, firms, optimize their resource allocation the total output of goods and services available to the society will be maximum. But it may not be so. Because private and public interests can and do conflict. Optimum resource allocation from an individual point of view may not conform to the tests of optimum allocation of resources from the point of view of social well being. The positive micro economic theory does not answer many problems relating to criteria of maximum social welfare and does not throw light on the designing of appropriate policy measures that can maximize the economic well-being of the society as a whole. The branch of economic analysis which is concerned with the problem of maximizing social welfare is called welfare economics.

1.2 SOME DEFINITIONS OF WELFARE ECONOMICS

Welfare Economics examines the conditions that maximize economic welfare of the society as a whole. Oscar Lange Says "Welfare economics is concerned with the conditions which determine the total economic welfare of a community". Reder defines welfare economics as that 'branch of economic science' which "attempts to establish and apply the criteria of propriety to economic policies".

Mishan explains the theoretical welfare economics as that "branch of study which endeavours to formulate propositions by which we may rank on the scale of better and worse, alternative economic situations open to the society. "So in welfare economics it is possible to evaluate alternative economic situations and determine the desired situation. It explains and evaluates the various economic situations from the view point of economic well- being of the society as a whole.

1.3 NATURE OF WELFARE ECONOMICS

Welfare economics is a kind of weasel – word with at least two commonly accepted meanings.

(i) It is the formal treatment of principles of economic policy which involves standards of judgement. Economic theory is applied and economic policy is generated in the analysis of social welfare. This makes welfare economics a generic term for the normative aspect of economics.

(ii) Welfare economics is an analysis of theoretical welfare economics. Then it deals with the formulation of welfare propositions or jugements based on factual and ethical assumptions to determine social optimum or optimum of social welfare. It is chiefly concerned with welfare theory.

Welfare economics is that branch of economics which sets up standards of judgement which helps to judge whether a situation is economically desirable or not. It enables one to rank various alternative economic situations opened to a society. Every society attempts to choose that policy which helps to attain maximum social welfare.

It is necessary to formulate a yard stick to ascertain whether social welfare has increased or decreased or social welfare is more or less. The yard stick provides standards of welfare judgement. They are the tools to examine the attainment of optimum social welfare. These welfare criteria become the basis for judging the propriety of economic polices or economic states from the point of view of maximization of welfare. The welfare criteria help to formulate propositions which serve as a basis for policy recommendations.

Welfare propositions are the outcome of logical exercises. The propositions are based on a set of definitions and on factual and ethical assumptions. In this exercise it is possible to deduce the conditions under which social welfare increases. Welfare propositions make use of factual and ethical assumptions and hence welfare propositions are normative in character.

Welfare propositions become practical when these propositions are based on widely acceptable ethical assumptions. It is possible to consider diverse ethical postulates theoretically. Then we get a host of welfare propositions. Then it is possible to have different views about the desirability of an economic state or system. Modern welfare economics is based upon one fundamental ethical assumption. Eg. Samuelson points out the consideration of individual preferences. This consideration helps to judge whether a situation is good or bad.

Welfare economics is a device to make a choice of economic policy from the view point of maximizing welfare. Welfare economics emphasizes optimum social welfare. Optimum social welfare consideration may overlook many other considerations which are assumed to be unaffected or at any rate not unfavourably affected by the changes in economic welfare. It may not indicate welfare maximisation with reference to maximizing unit and to time horizon. The maximizing unit may be national unit, a group of countries, whole world. It has no time horizon. It is not clear whether the objective refers to weighing of different generations. It is pointed out that the appropriate inclusion of objectives expressed local and temporal terms will naturally involve complex value judgement and multiple welfare criteria. Welfare maximization may thwart the conflicts between objectives viz full employment, price stability, social justice, conservation of natural resources and so on which need to be compromised. So the unpacking of the hold of all objectives of welfare maximization into several objectives would require multiple value judgements and multiple welfare criteria. It is only the pluralistic formulation of welfare maximization as to include a set of objectives that would enable the welfare economist to suggest and recommend suitable economic policies. There have been attempts in a number of recent writings to break away from the monistic treatment of the objectives and criteria of economic policies and to start from a manageable set of several objectives which constitute the welfare function for the policy maker. Eg. Tinbergen describes his set of objectives or aims as elements of welfare or the elements of entering into policy maker's function. The pluralistic formulation of objectives as compared with welfarist monism will help more effectively the elucidation of the policy choices and in the achievement of specific goals more effectively.

1.4 SUBJECT MATTER

The subject matter of welfare economics can be explained with the help of outlining the development of welfare economics and the purposes for which it stands for. Welfare economics as a separate entity became prominent in the later part of 19th century. Before this period, the classical writers like Adam Smith, Malthus, Ricardo, Mill combined analysis and advocacy. Their theories have a number of welfare implications. They adopted prescriptive approach to resolve economic problems.

Welfare economics attained a separate entity when A.C. Pigou wrote "Economics of welfare" Hyint points out that the classical economists have pointed out a great deal on wealth, trade, tax and others which can be brought under the scope of welfare economics. Pigou has elaborated the ideas of Marshall. So the ideas of Pigou and Marshall are treated as the ideas of New classical school. The work of Wilfred Pareto represents the emergence of welfare economics as separate school of economic thought. Economists like Lerner, Hicks, Kaldor, Hoteglling, Reader Bergson, Samuelson and others developed welfare economics taking the clue from Pareto. Kaldor, Hicks, Scitovsky, Little and others explain compensation criteria. Bergson and Arrow have attempted to construct social welfare function.

They argue that a unique social welfare function cannot be constructed, without imposition of dictatorship. Of late, writers like Anthony Down, J.M.Buchanan, Eardon Tullock have established linkage between welfare economics and politics. Welfare economics therefore has tended to be a social science of ethics and politics.

Welfare economics has analysed three issues Eg. Adamsmith explained wealth and welfare. He quantified them in the analysis. He measured economic welfare interms of physical output and utility. Utility is a subjective measurement. The subjective measurement has thrown light on the complexities involved in the measurement and has helped to identify the increase or decrease in welfare of the individual or group. Second, the welfare economists have explained ,welfare criteria, Paretian criteria and compensation principle to evaluate alternative situations. These enable to analyse maximization of welfare or to attain social optimum by applying the maximization techniques of price theory. Eg. Bergson-Samuelson social welfare function helps to arrive at unique optimum which combines economic efficiency with distributive justice. Third welfare proposition helps to provide policy guidance. Eg,SK Nath has said that there is nothing to say welfare economics is apriori Economic theory can be applied to study economic problems and given the value judgement the application of theory helps to process decision making. So welfare economics is policy economics.

1.5 POSITIVE ECONOMICS AND WELFARE ECONOMICS

Modern economic theory can be divided into Positive economics and Welfare economics. Positive economics explains 'what is ' of a situation. Normative economics explains "What ought to be" of a situation. Positive economics explains the working of an economic system. Welfare economics prescribes policy for the economic system to operate in a particular manner. Economic theory is prescriptive and hence normative in nature. Welfare Economics is normative. Eg. Price theory is adopted to the task of stating the norms or standards of an ideal economy in welfare economics. An ideal economy ensures the maximum of economic welfare-subjective satisfaction-obtainable from economic resources. So welfare economics is Normative in nature.

In any form of economy, capitalist or socialist, these are basic economic problems which have to be answered. The basic economic problems are (a) What to produce? (b)How much to produce? (c) How are the goods to be produced-or technology to be used ? (d) How are the products to be distributed ? (e) Are the resources utilized efficiently? These problems are answered with the objective of maximizing social welfare. The decisions regarding these problems are taken keeping in view the criteria of welfare judgement. The society decides what is desirable economically for the group or the society. Thus the tools of economics help to resolve the economic problems from the view point of maximizing social welfare.

There is major difference between welfare economics and positive economics. Positive economics are deduced from a set of assumptions. It is not possible to test the assumptions directly. The propositions are being tested by the observation of the real world. Eg. The law of demand explains the inverse relationship between the level of price and the quantity demanded. This law can be falsified, referred or verified by observation of market phenomenon.

Propositions in welfare economics like positive propositions in economics are logical deductions from a set of definitions and assumptions. After defining welfare conditions and making assumptions we can deduce conditions under which welfare increases or decreases. If the welfare does not increase despite the fulfillment of conditions it follows that the assumptions are wrong. Thus there is no difference between positive theory and normative theory. But the difficulty arises when welfare is increased. Because welfare is not an observable quantity. It cannot be observed like market price. It is difficult to test welfare propositions.

In positive economics conclusions are generally tested. In welfare economics the assumptions made have to be tested. So welfare criterion is difficult to be deduced. It is necessary to collect data and to make relevant ethical assumptions. In this regard Dr.Graff says that in positive economics the proof of the pudding is indeed in eating. In welfare economics the welfare cake is very hard to eat. One can only have the sample of ingredients before baking.

1.6 DEFINING INDIVIDUAL, GENERAL AND SOCIAL WELFARE.

In welfare economics we use individual welfare, social welfare, general welfare etc. They need to be defined.

Let us try to define welfare. Welfare to be defined invloues value judgement. It cannot be explained with empirical language. It is a value word.

How is welfare perceived? Answer to this does not involve value judgement. The study of the process of welfare perception is the domain of philosophy. Welfare perception or identification is applicable to any form of political, social and economic organization and which does not rule out any social intervention. Welfare of an individual is what that individual perceives it to be. It was Pigou who popularized the word welfare in Economics. Smith used wealth, happiness, satisfactions instead of welfare. IMD Little has employed happiness and welfare as synonyms.

1.7 GENERAL WELFARE AND ECONOMIC WELFARE

Welfare of a community, or a group or a community depends on economic and non economic factors. A comprehensive investigation of all the factors affecting welfare is intractable both from the stand point of analysis and of diverse nature of factors that affect welfare. Prof. Pigou has restricted the scope of Welfare Economics to Economic Welfare. Economic welfare is a part of general welfare. This can be brought directly or indirectly under the measuring rod of money. So it is the satisfaction derived from the use of exchangeable goods and services.

Welfare as explained by Pigou is a part of general welfare or social welfare. This is misleading. It is harmonius whole. There are no economic states of mind says Robbins. There are economic factors involved in the achievement of the states of mind. The measuring rod of money does not provide the accurate measurement of economic welfare.

Welfare economics deals with economic welfare, other aspects of welfare non economic welfare are generally assumed to be unaffected or at any rate not unfavorably affected by changes in economic welfare.

1.8 INDIVIDUAL WELFARE AND SOCIAL WELFARE.

The subject matter of welfare Economics is mainly social welfare. In welfare economics the contribution that economics can make to advancing social welfare is studied. Social welfare is the sum total of individual welfare. Then what is individual welfare?

It is difficult to define individual welfare in objective terms. Terms like calorie intake, integration of the personality, lingevioty, are arbitrary indicators, welfare is a state of mind. It is said that individual gets welfare when he consumes a good or enjoys a joy ride. It is remarked that Beer and Bible give satisfaction to the same individual but they are enjoyed at two different planes. One is sensual and another spiritual. Welfare resides in the state of mind. It consists of one's utility and satisfaction. Prof. Piogu has given subjectice interpretaion of individual welfare. He state welfare as states of consciousness. Modern economists have tried to link individual choice and welfare. This linking has made the measurement of welfare objective. It is possible to identify individual welfare. Eg. If individual welfare is more in A than in B, it means an individual chooses A to B the positive correspondence between welfare perception and preference helps to identify objectively the changes in welfare between any two situations.

Social welfare cannot be defined easily. Social welfare, either subjectively or objectively cannot be interpreted. Society in not an organic whole. It does not have a sigle mind. It is not reflected in social choice for unanimous social choice has proved to be unattainable. Social choice is derived from individual choices. Social welfare is the sum total of individual welfare. It involves interpersonal comparison of utility and aggregation. Social welfare makes use of value judgements.

Dr. Graff has furnished three concepts of social welfare.

(i) Paternalist concent of social welfare ignores individual preference. It decides what is welfare for the society. Paternalist authority may or may not take economic content of welfare in terms of national income and its distribution. An economist cannot say anything about welfare until the concept of welfare of the paternalist is made known.

(ii) Social welfare is based on Pareto's welfare critera. It rules out interpersonal comparision of utility and accepts a simple ethical postulate that it is a good thing to do good to others. Social welfare formulated on Paretian assumptions will result in heterogeneous collection of individual welfares. Paretian type of social welfare states that if any reorganization or change makes at least one person better off and none worse off, then group welfare increases.

(iii) The third concept of social welfare admits the inter-personal comparisons with some explicit value judgement. This is suggested by Bergson. Bergson social Welfare function is the individualist type. This may be expressed as $W(u^1, u^2 \ldots\ldots\ldots u^n)u$ are the utility functions. They are the choice indicators of n numbers of society. The ethical postulate assumed denotes the method of adding individual members of the society.

Bergson type of social welfare function has a high degree of generality. It has diverse set of value judgement. With this Paretian class of welfare functions can be formulated. It is possible to evolve Paternalist type of rocialist function. Paternalist type of social welfare reflects the views of paternalist authority and the variables on which the social welfare function depends will not denote individual utility functions. In Paretian type of social-welfare function non-admissibility of inter-personal comparison holds good. But the change in welfare of the society can be expressed with a broad ethical judgement (that is good thing to do is to do good to others).

1.9 VALUE JUDGEMENT IN WELFARE ECONOMICS

Welfare economics is basically founded on value judgements, welfare propositions are in the form of ethical postulates. IMD Little has pointed out that welfare economics and ethics cannot be separated. Welfare terminology is a value terminology. One takes up moral interest in welfare and happiness.

Value judgement is essential in welfare economics for a number of reasons. The term welfare is a valuation term and not an observation term. Welfare cannot be expressed in empiricist language. Thus welfare term is a value word which must be assigned some definite meaning.

The objective of the study of welfare economics is to find out what is the best thing to do in various situations. It prescribes policies. It has to consider what is desirable, good or of some social objective. This requires implicit and explicit value judgements..

Welfare Economics is concerned with the social welfare and not with individual welfare. A criterion of an increase or change in the welfare of individuals is the basis from which we can deduce changes in social welfare. Social welfare comprises of individual welfare, But the transition from individual to special welfare involves the problems of interpersonal comparisons and of aggregation. These problems can be settled by assuming some value judgement.

NATURE OF VALUE JUDGEMENT

It is difficult to define value judgement. There are many definitions . From the stand point of scientific objectivity i.e, political and ethical neutrality-which helps to distinguish between positive statements and normative statements, it is possible to define value judgement Eg. K.R. Popper has given "demarcation criterion". Accordingly statements may be scientific and non scientific. Scientific statements are inter-subjectively testable. Non scientific statements cannot be verified. Ethical and political judgements, value premises, prescriptions and persuasive judgements constitute nonscientific or the whole class of value judgements.

Value judgements are positive statements. They are discussable. They are subject to rational examination. Value judgements contain some positive and normative elements and they should be separated out for arriving at conclusions. E.g. "Price Stability should be maintained" is a value judgement. Once this objective is accepted it is possible to discuss its desirability causes and consequences of price stability and policy measures towards the attainment may be suggested.

S.K.Nath has given a broad definition of value judgement. Any statement which implies recommendation is a value judgement. Any statement which implies recommendation of any kind is a value judgement. It includes all ethical judgements and descriptive statements, statements which are recommendatary persuasive or influential. We can take a few examples. Adamsmith remarks that defence is better than opulence. This is suggestive and recommendatory statement. These is another statement. An increase in National income would increase social welfare. It describes a fact and suggests what ought to be done to increase welfare. Direct tax may be preferred to bring about equality in distribution of wealth. All these statements are suggestive and are value judgements.

IMD Little says any persuasive statement is a value judgement. Many economic statements may appear descriptive. But they have value implications. The phrases like increase in welfare, increase in real income have to be made terminologically clear interms of what ought to be done. Persuasive definitions must influence what is judged important or desirable in either political or ethical respects.

Value judgements are those judgements which help to make clear what is desirable or not desirable. They denote either ethical or political desirability value judgements have no scientific validity and are not falsifiable.

The basic purpose of welfare economics is to formulate welfare criteria so that the desirability of economic policies or economic state can be evaluated. The development of welfare criteria involves value judgement. We can see this by examining various criteria offered.

(i) Pigou has explained dual criteria (you are going to study this in the third Block) for judging improvements in social welfare. He considers the size of the national dividend and the distribution of income.

(ii) Pareto criterion also makes value judgement (you are going to know about this in third block

(iii) Hicks-Kaldor compensation criterian which evaluates those economic changes which benefit some and harm others. According to I M D Little Hicks-Kaldor criterion involves value judgement.

(iv) Economists like Abram Bergson and his followers like Samuelson, Little and others have maintained that welfare conclusions are based on value judgement. (You are going study them in third and fourth block).

There are two views about value judgments in economics. (1) Prof Robbins emphasized purely neutral analysis. He has tried to separate Ethics from Economics by making Economics purely a positive science.

(2) The second group of economists comprise of Samuelson, I M D Little, Bergson who hold the view that welfare prescriptions cannot be made without value judgement.

1.10 LET US SUM UP

Welfare Economics is that branch of economics which is concerned with the problem of maximizing social welfare. It examines the condition that maximizes economic welfare of the society as a whole. It is the formal treatment of principles of economic policy which involves standards of judgement. Welfare propositions are based on value judgements.

1.11 SOME BOOKS

1. Kundu	-	Welfare Economics
2. I M D Little	-	A Critique of Welfare Economics
3. J de v Graaff	-	Theoretical Welfare Economics

1.12 QUESTIONS

1. Discuss the subject matter of welfare economics.

2. Examine the view that welfare propositions are based on value judgement.

Note

12

UNIT-2 NATURE AND SCOPE OF WELFARE ECONOMICS-II

Structure

2.0 OBJECTIVES

A study of this unit enables you to explain

* The meaning of welfare state.
* Functions of a welfare state.
* Need for state intervention in various economic activities

2.1 INTRODUCTION

In this unit an analysis of the role of the Government in unifying economic growth and social welfare is undertaken. If economic growth is accompanied by social welfare, growing material wealth becomes meaningful in terms of human values.

Let us presuppose that there is the existence of a democratic welfare state. It is ready and willing to adopt deliberately such policies as would achieve what Sir Roy Harold calls "the welfare optimum". In this achievement the society does not sacrifice liberty, equity, amenity, variety, gaiety and other social values. No country in the world would tolerate the classical "abstinence of the rich" based on great income disparities, artificial expansion of output and employment based on precarious warlike stimuli, rapid but unstable formation of capital based on forced consumer austerity or laissez-faire producer activity.

The present day governments are convinced that welfare content of an expanding GNP must be accompanied by "the greatest happiness of the greatest number". This calls for sectoral aiding, institutional remoulding and cultural reconditioning. The developing countries at present are adopting Keynesian macro economic controls (fiscal-monetary) with state ownership of selective enterprises. They are synchronizing post Keynesian emphasis on the growth of effective demand with the new classical stress on the growth of productive capacity and equitable distribution of wealth and incomes. The Government of the present world are not ignoring the democraic will of the people in general.

2.2 CONCEPT AND EVOLUTION OF WELFARE STATE

There are two concepts of welfare state. A welfare state in the west which provides a wide range of social services like education, health unemployment benefits. Old age pension and so on. Welfare state attempts to provide economic security to its citizens. Apart from these types of normal services the welfare state provides benefit known as national assistance to the poor. Weltare state takes special care to provide Health assistance, compulsory education which is free upto a stage. Such welfare states are seen in U.S. Britain, Australia, Newzealand, Canada etc.

In less developed countries like India state provides basic social services. It also takes up services like rural development, labour welfare and reducing economic inequalities.

"Welfare" is the result of industrialization of 19th and 20th centuries. It was found earlier also. In Europe in the middle ages church used to take up the welfare of poor. In England in 16th century poor Laws were enacted to look after the poor. It continued till the end of 18th century. In 19th century the doctrine of Laissez-faire advocated non intervention of the Government in economic activities. Although there was increased output, it resulted in uneven distribution of wealth because of the policy of "neutral" state. There were economic fluctuations. This led to the starting of a movement towards greater social justice. It met with little success.

Towards the end of 19th century under the leadership of Bismarck of Germany a social security scheme was introduced which was taken up by all the countries of the west. There were social security schemes such as sickness insurance, old age pensions and unemployment insurance.

There were two important events in the 20th century which have revolutionized human thinking – one Russian Revolution of 1917 and other was the Great Depression of 1929-33. The first was the revolution of the labour class and the peasant against the existing order. This made the democratic world to take up measures to establish social justice and abolish the extreme inequalities of income. LDCS have taken up measures for rapid economic development taking inspiration from the example of Russia.

The great depression of 1929-33 brought out clearly that the capitalist economy may not be able to use technical development so as to achieve fullest production and raise General standard of living. The depression showed the importance of distribution. It was felt that greater social justice and more economic democracy were required to make the economy fully employed and improve the standard of living. The welfare state owes its existence to teachings of Marshall, Pigou, Keynes, Beveridge, Bergson and Karl Marx.

Welfare state developed under the influence of socialist principles of equality and justice. It is compatible in a capitalist economy. Eg,U.S.A. has provided a considerable social services. But there is considerable uneven distribution of wealth. In Russia although a socialist country many important social services have not been provided.

A welfare state is not a separate economic organization just as a capitalist economy or socialist economy. It refers to the types of services provided by the state to its citizens. All countries have elements of the welfare state in their arrangements, the differences are only of degree.

2.3 DIFFERENT FUNCTIONS OF WELFARE STATE

There are a number of economic activities of a state at present. The activities of a state or a Government share the course of development. They affect aggregate resource use and financing patterns in an economy. They affect monetary and exchange rate policy influence the balance of payment, accumulation of foreign debt, rate of inflation, interest and exchange. They affect the behaviour of producers and consumers. They influence the distribution of wealth and income in the country. Economic activities of the Government extend to almost all aspects of life of an individual as also of the whole society.

2.4 ALLOCATION FUNCTION

Allocation function is a very important function of a welfare state. Every society faces the basic economic problem. Resources available to a society are limited. Resources may be natural resources or factors of production like land, labour, capital and organization. The state of technology may also be limited. All these point out the need for allocation of resources in an economy.

In an economic system it is necessary to determine the pattern of production. Which economic good should be produced must be decided. In what quantities they should be produced is another matter to be decided. Allocation function has another dimension at present. It is concerned with institutional means through which the allocation decision are processed. Modern society has two institutions through which allocation branch of economics is made, private sector and the Government institution namely public sector. (Allocation function of the Government is explained in M.A. previous in course IV unit 1)

There are various allocational instruments which are used to influence resource allocation in an economy. The instruments are applied directly and completely by Government. They are used to finance and produce Economic goods. They also produce component parts of the goods and can directly control all resources used in the production of the component. Eg. Defence. These goods are financed by taxation.

The public sector finances and produces an economic good but purchases some or all components or productive resources including labour in the market. It does not charge directly for the good but instead finance it via taxation. Public sector may also control or own the monetary system.

The Government may provide an economic good by charging a price. It may influence the allocation of resources in a society through its policy of subsidies, regulation, production, joint venture, ratio, consumption of goods and resources, controlling quality, license, insurance, patent rights, General antitrust regulation, fiscal measures and property rights.

It may be argued that all resource allocation decisions could be made within the market mechanism except for providing law and order, and other fundamental government function. Why then does public sector exist for resource allocation in a society?

Smith made out a case for public sector on four justifiable categories of Government allocational activity.

1. Maintaining external security (National Defence)
2. Maintaining internal peace (law and order)
3. Establishing and maintaining Highly beneficial public institutions and public
4. Meeting the expenses necessary to support soverign

The functions relating to national defence and public works have increased with civilization. Warfare has changed with the invention of fire arms. As the cost of factors is increasing the public work function has assumed importance because roads, bridges , canals, harbours, education, health have to be taken up by the Government , because private individuals, cannot effectively perform on the one hand and they will not on the other hand in this regard.

J.M.Keynes reiterated the views of Adam Smith and Mill on the importance of public works allocation by the Government. It is pointed out that the market failure is an important aspect which has made the intervention of the public sector necessary in optimum allocation of resources. The objective of public sector undertaking to intervene in the allocation of resource is to produce social-optimun output. Allocational; complications arise under.

1. Decreasing cost of production and under imperfect market condition.
2. Zero marginal cost.
3. Joint consumption
4. Externalities
5. Special supply phenomena which can cause failure in market efforts to allocate resources. (Eg. Inadequate market knowledge)

The public sector intervenes in allocation of resources to attain maximum social welfare. The intervention is done to overcome economic inefficiency. Allocation function is discussed in a normative approach. Emphasis is laid on deriving condition of Pareto efficiency.

2.5 DISTRIBUTIVE FUNCTION

The allocation function is the classical function of the budget policy. It was held that fiscal problem was pure and simple. There was no economic and social consideration. But a policy of the Government does have economic and social consideration. They may be directed to attain ends not connected with allocation function that is satisfaction of social wants. One such objective is to secure adjustment in the distribution of income and wealth that might be considered "fair" or "just" by the society. This is the distributive function of the budget policy.

The distribution function aims at shifting resources from the disposal of one individual to that of another. A given distribution of income may or may not be fair from the point of view of society and the market forces cannot be trusted to achieve the result desired by the society. So Government through its budgetary policy can bring about the desired change.

The main reason for income inequality in a market economy is the payment of factor prices (wages, rent, interest) according to the productivity of factors of production. The market system results in a kind of meritocracy in which merit (income) is accorded to those who are endowed with or who acquire the ability to be productive according to the specification of the system. The market does not make provision to pay those who do not have the specification necessary (except charity and philanthropy) , The system does not support such factors. Besides Monopoly also results in inequality in the distribution of income in a market system. Market economy calls for private property. All these result in the creation of unequal distribution of income and wealth. Law of inheritance widens the degree of inequality.

In welfare economics a consideration is made about economic efficiency in a given income distribution. An economic reorganization may improve economic welfare. Eg. if the position of one individual improves without making any other worse off then social welfare improves. Social philosophy and value judgements are considered here. At present emphasis on reduction of poverty, providing minimum level of income, fixing a ceiling on high income etc is made. Realisation of these involve tax transfers schemes, negative income tax, progressive income tax etc.