K. Christ / History of Economic Thought
8: Neoclassicism and Welfare economics

Outline

From Wikipedia: *Neoclassical economics* is a term variously used for approaches to economics focusing on the determination of prices, outputs, and income distributions in markets through supply and demand, often mediated through a hypothesized maximization of utility by income-constrained individuals and of profits by cost-constrained firms employing available information and factors of production, in accordance with rational choice theory. Neoclassical economics dominates microeconomics, and together with Keynesian economics forms the *neoclassical synthesis* which dominates mainstream economics today.

I. Second-Generation Marginalists and Neoclassicism

- Francis Edgeworth (1845 – 1926) – Early British advocate of mathematical analysis.
- Vilfredo Pareto (1848 – 1923) – Pareto efficiency, the Pareto criterion, and early statements on welfare economics.
- Arthur Cecil Pigou (1877 – 1959) – Marshal's heir at Cambridge, father of modern welfare economics, and eventually, Keynes's foil.
- John Bates Clark (1847 – 1938) – Expositor of the modern marginal productivity theory of distribution.
- Irving Fisher (1868 – 1947) – Early monetary theory.

II. Ethics, economics and value neutrality

Almost from its birth, modern economics (a.k.a, "neoclassicisim"), in pursuit of status as a "true" science, seems to have been preoccupied with separating itself from its roots in moral philosophy (remember, Adam Smith was a moral philosopher coming out of the Scottish Enlightenment tradition). The process seems to have begun very early on – with David Ricardo and Nassau Senior often cited as early economists who sought to narrow the domain of the emerging discipline. But it was not until Lionel Robbins's *An Essay on the Nature and Significance of Econmic Science* (1932) that we begin to see an unyielding attitude among economists regarding the separation of ethics from economics.

- Early classical views on the relationship of ethics to economics
- Late 19th century views – a complicated mixture of economic science and ethical sensitivity
- Lionel Robbins (1898 – 1984) and the German concept of *Wertfreiheit* – value-free science.

Helpful secondary text: Armartya Sen, *On Ethics and Economics.* Sen's thesis (p. 7):

> "…the nature of modern economics has been substantially impoverished by the distance that has grown between economics and ethics."

III. Welfare economics and social choice theory

The basic aim of welfare economics is to provide criteria according to which various policy proposals can be ranked. Given the ethos of ethical neutrality within economics, it is not surprising that welfare economics has been marginalized.

- Early engineering influences – Claude Navier (1785 – 1836) and Jules Dupuit (1804 – 1866)
- Jeremy Bentham (1748 – 1832) and utilitarianism
- The Cambridge tradition in welfare economics – Henry Sidgwick (1838 – 1900), Arthur Cecil Pigou (1877–1959)
- The "New" Welfare economics: the Pareto criterion and compensation principles
- Social choice theory
  Early French influences – Etienne Condillac (1715 – 1780) and Jean-Charles de Borda (1733 – 1799)
  Kenneth Arrow's (1921 –) treatment of social choice theory and the impossibility theorem Arrow – Debreu (Gerard Debreu, 1921 –) formulation of "fundamental theorems of welfare economics"