

**A Comment on "Incorporating the Social Dimension into Economic and Social Planning," by W.H. Parris**

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ECLAC, in the introduction to its document Social Equity and Changing Production Patterns: An Integrated Approach (1992, p. 14) emphasises that

"the secretariat is deliberately abstaining from becoming embroiled in the theoretical aspects of a controversy which has raged for centuries, and particularly since the French revolution, i.e., the debate surrounding the cause-and-effect relationships and possible areas of incompatibility among democratic governance, economic stability, growth and well-being. Rather than concerning itself with doctrine, the secretariat prefers to deal with the realities confronting virtually all the Governments of the region."

In other words, ECLAC's approach is one of pragmatism.

In contrast, despite the title of his paper, Mr Parris elects to probe the philosophical foundations on which all economic policy necessarily is based. He accepts uncritically the politically conservative message of Welfare Economics and adds to it a large dose of Relativism. None of this is of recent origin: Welfare Economics dates from Pareto (1896-1897) and Relativism dates at least from Protagoras, a leading Greek Sophist of the 5th century B.C.

1. Welfare Economics

The gist of Welfare Economics can be illustrated with the aid of a diagram taken from Williamson (1993). Figure 1 contains the familiar production possibilities frontier, known also as a transformation curve. The curve AB describes, however not a tradeoff between two goods, such as wine and cloth, but rather a tradeoff between equity and efficiency. Efficiency, measured along the vertical axis, is the value of society's total output, measured

at border prices (f.o.b. for exportables, c.i.f. for importables).

For simplicity, we abstract from nontradables and assume that the country in question is small, so that output can be transformed into any desirable basket of goods for consumption at fixed terms of trade.

Equity is measured along the vertical axis, and can be any suitable index, such as the reciprocal of the variance of per capita (or family) income, or unity minus the Gini coefficient. First, however, income should be adjusted to allow for differing real income needs due to differing ages and health of members of society. A perfectly egalitarian distribution of nominal income is not egalitarian if real income needs vary from individual to individual, or from family to family.

In figure 1, B represents the point of maximum income (efficiency) at the cost of an extremely concentrated distribution of income. The transformation curve AB represents the amount of income that must be foregone, moving in a north-westerly direction, in order to obtain an increasingly equitable distribution of income.

Before continuing, an important caveat should be noted: Diagrams such as figure 1 are useful to illustrate options in a comparative static framework; they are not appropriate for the study of choices related to economic

dynamics. A message of ECLAC (1992, pp. 16-17) is precisely that policies sometimes involve a short-term conflict between equity and income, but a long-term complementarity between equity and growth.

Examples are investments in conservation of the environment and investments in education and health. The 'efficiency' of figure 1 thus refers exclusively to static efficiency.

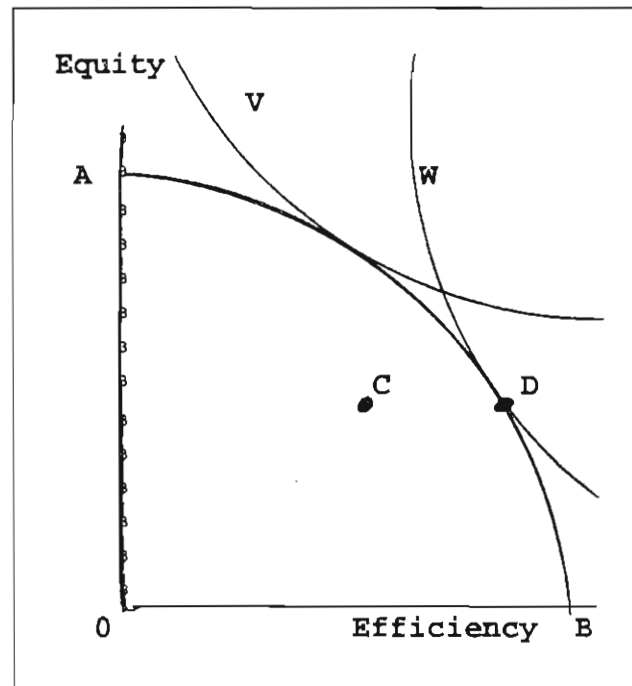


Figure 1. The Equity-Efficiency Tradeoff

Even in the short-run, no conflict exists between equity and efficiency if the economy is producing at a point located within the production possibility frontier. It is possible, for example, to move from a point like C, well within the frontier, to a point like D, which is on the frontier, thus obtaining increased income with no loss of equity. Welfare Economics traditionally abstains from inter-personal comparisons, giving rise to the criterion of Pareto optimality: increased welfare for a group of persons represents an improvement for society as a whole only if no individual suffers as a result. At a high level of abstraction, the move from C to D would appear to satisfy this criterion, since everyone gains from the change. Once the frontier has been reached, movements along the curve AB are not Pareto optimal, for some individuals gain at the expense of others.

In the 'real world', even moves from a point such as C toward the transformation curve will not in general be Pareto optimal, since nearly any policy change will harm at least some members of society. Consider the case of a 'white elephant', for example a national airline that loses money year in and year out, has no prospect of ever covering its costs, and is financed by the treasury (i.e. the taxpayers) of the country. If the airline is closed, there would be an obvious increase in efficiency. But the change is not Pareto optimal, for employees of the airline would be worse off as a result of the closure. Pareto optimality is recipe for inaction.

One escape from this impasse lies in the compensation principle proposed by Kaldor (1939) and modified by Scitovsky (1941): a policy change is an improvement if winners can more than compensate the losers. Note that the compensation is hypothetical; actual compensation would return us to the criterion of Pareto. Kaldor in fact was adamant that compensation not be paid, on grounds that his was a test of economic efficiency, separate from the question of equity, on which the economist has no special right to an opinion. Note also that the compensation is with money, of which the wealthy have more, so the principle will cause society to move to a point of maximum efficiency like B in figure 1, with a highly skewed distribution of income.

The politically conservative nature of the compensation principle will become even more evident with an example that doesn't involve the concept of efficiency. Suppose that a small

Caribbean island inhabited by 1,000 wealthy retirees and 20,000 low-income workers has a limited number of beaches suitable for bathing. Assume that these beaches are public, freely accessible to rich and poor alike. Consider a policy change to charge a non-trivial fee for the use of beaches that would, in effect, exclude the poor. Such a change would never pass the Pareto criterion, but it could easily pass the compensation principle if the income of the island is sufficiently concentrated in the hands of the wealthy.<sup>1</sup>

Another way to escape the inertia of Pareto optimality is by means of the social welfare function introduced by Bergson (1938).

Such a function combines and ranks all combinations of individual welfare according to explicit value judgements concerning the distribution of income. In figure 1, two such functions are shown in a manner analogous to an individual's indifference map, with different combinations of equity and efficiency yielding the same level of welfare. Welfare function "V" is more egalitarian than (politically to the left of) welfare function "W."

Unfortunately, it is not clear whose value judgements the social welfare function is to reflect or how we are to reconcile individual differences in these judgements. Kenneth Arrow (1951) demonstrated, in fact, if certain "reasonable" conditions are to be met, it is impossible for a democratic, liberal society to arrive at a social welfare function. This finding, known as the Arrow Impossibility Theorem, decreased markedly the attractiveness of the social welfare function in liberal circles.

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<sup>1</sup> Williamson (1993, p. 1335) comments on the conservative bias of the compensation principle and notes that "paradoxically [it] was developed by two left-of-centre economists, Tibor Scitovsky and Nicholas Kaldor." The two economists may have been unaware of this conservative bias at the time they wrote, for the policy change they cite is one in which the wealthy were losers, namely Britain's repeal of its protectionist Corn Laws in 1846. No compensation was paid, so repeal of the Corn Laws was not Pareto optimal; but no one doubts that it increased the real income of consumers by an amount greater than the decrease in real income of landlords.

## 2. Relativism

The Relativist asserts that what is true or right or good depends solely on the perception of an individual or society: There are no universal truths, and societies cannot be ranked in terms of better or worse. This philosophical doctrine, which dates from the ancient Greeks, entered modern social science largely because of the influence of the German sociologists Max Weber (1864-1920) and Karl Mannheim (1893-1947). It reaches maximum expression in anthropologists, who found in Relativism an escape from the ethnocentrism of European scholars. Nonetheless, Relativism has had virtually no impact on economic thought, medicine or any of the physical sciences.

Parris, in accepting the proposition that "Where vantage points are different, two diametrically opposed perceptions may both be 'right'" (p. 5 and addendum p. 1) clearly inserts the doctrine of Relativism into economics. Moreover, he asserts that

"there is no possible way ... of putting to rest any argument about whether one economy is more developed than another, or whether the same economy is more developed than it used to be. The issue simply becomes one of definition - the economy is more developed because I have defined it to be so" (p. 17).

Parris thus takes an extreme position, which limits the role of the economist or economic planner to that of an observer who, like the anthropologist, abstains from interference in the economy. After all, the economist has no grounds on which to claim that his interference will improve society.

It is important to note that Parris allows for an exception from this policy of aloofness if the very survival of society is in question. On pp. 21-23, he discusses the need to construct a number of "survival parameters," for which "any prolonged change ..., outside certain ranges, is survival threatening." This begs the question of how one is to know when the survival of a society is threatened. Is emigration -- 'voting with one's feet' -- evidence that society's survival is threatened? What of starvation, unemployment, civil disobedience, illiteracy, or reduced life expectancy? Regardless of the criteria adopted, a judgement must

be made. This necessarily requires abandoning the doctrine of Relativism. If Relativism is to be abandoned at this late stage, why not abandon it sooner, before society is on the verge of collapse?

### 3. Conclusion

Welfare Economics and Relativism each have a respectable intellectual lineage, and to debate their tenets is interesting and challenging.<sup>2</sup> It is impossible to keep politics out of this debate, for both traditions favour ruling elites and the status quo. Those of us who believe that it is a task of government to promote both equity and growth have grave difficulty accepting such doctrines.

There is an intellectually honest alternative to these conservative approaches, namely revival of the venerable social welfare function. To allow for democratic voting, avoidance of the Arrow Impossibility Theorem requires an assumption of 'single-peaked preferences' as commonly invoked in the public finance literature. In colloquial language, this means that individuals are free to prefer the political right, left or centre, but never to favour both extremes (right and left) over the centre.<sup>3</sup> A 'rightist' is assumed to prefer positions in the centre over those of the left, and a 'leftist' the centre over the right. In addition, if externalities are allowed, then the welfare of one member of society affects the welfare of all others. This, if you like, may be nothing more than enlightened self-interest, for the number of vagrants, illiterates and unemployed directly affects each individual's own safety and sense of well-being. In any case, it makes the individual welfare functions interdependent and facilitates construction of a social welfare function.

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<sup>2</sup> I am not convinced, however, that a meeting of economic planners is the appropriate forum for such a debate.

<sup>3</sup> In Parris' example (p. 7), if X, Y and Z are ordered from political right to political left (or from left to right), a voter cannot prefer Z to X and X to Y. This avoids Condorcet's paradox, hence Arrow's Impossibility Theorem.

Agreement on a social welfare function is easier to the extent that consensus exists. Consensus differs from society to society, but the scope of consensus seems to be steadily increasing over time. Two centuries ago, for example, few societies had reached a consensus concerning slavery and servitude; now virtually all of mankind has done so.<sup>4</sup> In fact, prohibition of slavery and servitude is enshrined as article 4 of the Universal Declaration of Human Rights adopted by the General Assembly of the United Nations on 10 December 1948 as "a common standard of achievement for all peoples and all nations." This Declaration represents metanational consensus, so it is useful to remind ourselves of some of its references to economics and equity:

Article 13 - freedom of residence within a country; right to exit any country and return to one's own country;

Article 17 - private property rights;

Article 21 - free elections by universal suffrage;

Article 23 - equal pay for equal work; right to form and to join trade unions;

Article 25 - right to security in the event of unemployment, sickness, disability, widowhood, old age, etc.;

Article 26 - right to education (free and compulsory in primary years, equal access on the basis of merit to secondary and higher education)

Article 27 - protection for authors of scientific, literary or artistic works.

These and other rights are elaborated in greater detail in the International Covenant on Economic, Social and Cultural Rights and the International Covenant on Civil and Political Rights, both of

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<sup>4</sup> Note that consensus does not imply unanimity of belief, for there will always be minorities that do not share or are antagonistic toward the dominant consensus.

which were adopted unanimously by the General Assembly on 16 December 1966.

After examining the degree of consensus reached by the nations of this planet, it is not difficult to imagine that individual states, with populations that are much more homogeneous, with much more social cohesion, can do much better. The social dimension can and should be incorporated into national planning; considerations of equity ought to be integrated with those of efficiency, for it is nearly impossible to change one without affecting the other.

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