

## HOW ECONOMISTS BASTARDIZED BENTHAMITE UTILITARIANISM

### A. BENTHAMITE UTILITARIANISM

Jeremy Bentham (1748-1832), an English philosopher, entered Oxford University at the ripe age 12 and graduated from there at age 15. He was, like, the perfect geek, probably never once engaging in binge-drinking or stuff like that.

He and John Stuart Mill (1806-1873) are widely regarded as the founders of the controversial philosophical school called *Consequentialists*.

*Consequentialists* hold that the merits or demerits of human acts – business decisions, legislation, crime and punishment – should be judged strictly by the pleasure or pain, or both, that these acts visit on human beings (or animals), rather than by some other intrinsic merit or demerit of those acts (e.g., some religious stricture).

Bentham called the attempt to value the total consequences of pleasure and pain of an act as the *felicific calculus*. You have had occasion to engage in *felicific calculus* on some your homework assignments, and some day you will hire economists who will perform it for you. You used it in what we have called “welfare analysis,” when we added up triangles under demand curves and above supply curves to calculate what we have called “social surplus.” In fashioning their normative *dicta*, economists seek to maximize this mysterious something called “social surplus.”



Jeremy Bentham

Bentham, Mill and their disciples believed that the pleasure and/or pain begotten by an act could be quantified and measured as “utility” or “disutility,” which is why they are also known by the more common label of “utilitarians.” They argued that public policy – in local commerce, in international trade and in the law -- should be conducted so as to *maximize the sum of utility (happiness) in society* which, you will quickly recognize, is roughly the same idea that drives modern welfare economics as well. In fact, 19<sup>th</sup> century utilitarianism can be regarded as the intellectual foundation for what we now know as “welfare economics” or “benefit-cost analysis.”

Modern welfare economists are *Consequentialists par excellence*.

The practical problem with utilitarianism – and with its modern successor, welfare economics -- is how to quantify and measure utility and disutility (happiness and unhappiness), especially in a manner that allows one to make *inter-personal utility comparisons* and to sum utility across different individuals into what economists call “social welfare.”

If you read the writings of the 19<sup>th</sup> century utilitarians, especially of Bentham, you will discover that they were not at all cavalier about the *cardinality* of utility in practice (where by “*cardinality*” is meant that utility or disutility could be quantified and measured so that, say, 150 utils represented 50% more pleasure than 100 utils, and so on.)<sup>1</sup>

Furthermore, they recognized that there existed inter-personal dependencies of utility – what we have called externalities in consumption – and that it would be extraordinarily difficult in practice to make inter-personal utility comparisons, or to sum utilities over different people, without attaching additive weights to individuals. Such weights, for example, might count the utils of some person as more than those of others.

Finally, and very importantly, the utilitarians assumed that the *marginal utility of wealth was strongly diminishing*. In Jeremy Bentham’s words:

*Of two people having unequal fortunes, he who has most wealth must by a legislator be regarded as having most happiness. But the quantity of happiness will not go on increasing in anything near the same proportion as the quantity of wealth: ten thousand times the quantity of wealth will not bring with it ten thousand times the quantity of happiness.*

*It will even be matter of doubt, whether ten thousand times the wealth will in general bring with it twice the happiness. The effect of wealth in the production of happiness goes on diminishing, as the quantity by which the wealth of one man exceeds that of another goes on increasing: In other words, the quantity of happiness produced by a particle of wealth (each particle being of the same magnitude) will be less at every particle; the second will produce less than the first, the third than the second, and so on.*<sup>2</sup>

The practical implication of the hypothesis of *diminishing marginal utility of wealth* in the context of Benthamite utilitarianism is momentous. It implies, *inter alia*, that public policy should achieve a more equal distribution of wealth than would be begotten by a market system left to its own devices. The hypothesis has been used by Benthamite philosophers to advocate progressive taxation, on the “equal sacrifice” principle—equal in terms of disutility of taxes, that is, not equal in

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<sup>1</sup> In modern consumer choice theory, we deal with *ordinal* utility. It means that we merely can say that a person prefers a thing to something else. Thus, if a person assigns 150 utils to good A and only 100 utils to good B, we can merely say that good A is preferred by the person to B, but we cannot say that the person derives 50% more happiness from good A than from good B.

<sup>2</sup> [http://highered.mcgraw-hill.com/sites/0072875577/student\\_view0/chapter3/origin\\_of\\_the\\_idea.html#2](http://highered.mcgraw-hill.com/sites/0072875577/student_view0/chapter3/origin_of_the_idea.html#2). By the way, as is mentioned in this source “Bentham donated his own body for dissection, largely to promote acceptance of the practice. This, however, was not the end of Jeremy Bentham. He also left his estate to University College, London, but under the condition that his remains be present at all board meetings. His padded and dressed skeleton still sits (in a glass case) at the college. A wax head sits atop the body, and his actual head was preserved using South American headhunting techniques. Bentham's real head used to sit on a plate between his feet, but in recent years has been relocated to a safe at the college, presumably to protect it from would-be pranksters using it on the soccer pitch or in other unspeakable ways.”

terms of sacrifices of money.

## B. UTILITARIANISM AND MODERN WELFARE ECONOMICS

Modern welfare economics, as already noted, can be viewed as an offshoot of Benthamite utilitarianism, but modified in dubious ways. Let us see why this is so.

To apply Bentham's utilitarian construct to their analyses, as they do, modern welfare economists must make two assumptions:

1. **First**, that the pleasure (or "economic welfare") that a person derives from a good thing can be measured *cardinally* by the money price he or she is willing to bid for the thing.

When you think about it, this assumption is not unreasonable if it is applied to one person only. For example, if person A is willing to pay \$10 for one thing and \$5 for another, it is not implausible to argue that (s)he expects to derive twice as much happiness from the first thing than from the second. Similarly, if that person is willing to bid \$10 to have one unit of a thing per period but only \$5 for a second unit in the same period, we can reasonably hold that the second unit will yield him or her only half as much pleasure as the first. Psychologists, of course, might demur; but as an operative assumption it does not affront one's intuition.

2. **Second**, that an additional, say, \$100 will yield the same pleasure to a billionaire as it would to a pauper, and that a \$100 loss will visit on the billionaire the same degree and intensity of pain as it would on the pauper.

This is the dubious assumption, because it affronts one's intuition. Obviously it departs sharply from Bentham's conception of human nature. Psychologist probably would find it risible.

Alas, the second of these assumptions is crucial to welfare economics. It allows economists to make statements such as "*on the efficiency criterion any change in policy that makes George \$2 richer and Martha only \$1 poorer is a good thing,*"<sup>3</sup> without any thought given to the relative amounts of wealth possessed by these two human beings.

Implicitly, however, most benefit-cost analyses offered by economists proceed on this assumption, aside from the rare instances in which economists use distributive weights, that is, weight equal dollar benefits or costs accruing to different people differently. Such weights, however, would be purely subjective.

## C. MAKING THE SOCIAL VALUE OF THINGS (INCLUDING HEALTH CARE) DEPENDENT ON THE WEALTH OF THEIR RECIPIENTS.

To illustrate what has just been said, consider the market demand curve for a certain thing, shown on the next page. Points E, F and B on that market demand curve can be thought to represent to maximum bid prices offered by individual buyers of the thing. Although each individual may be represented by more than one point on the demand curve, it helps us here to make the harmless assumption that each individual buys at most one unit of the thing being traded per period.

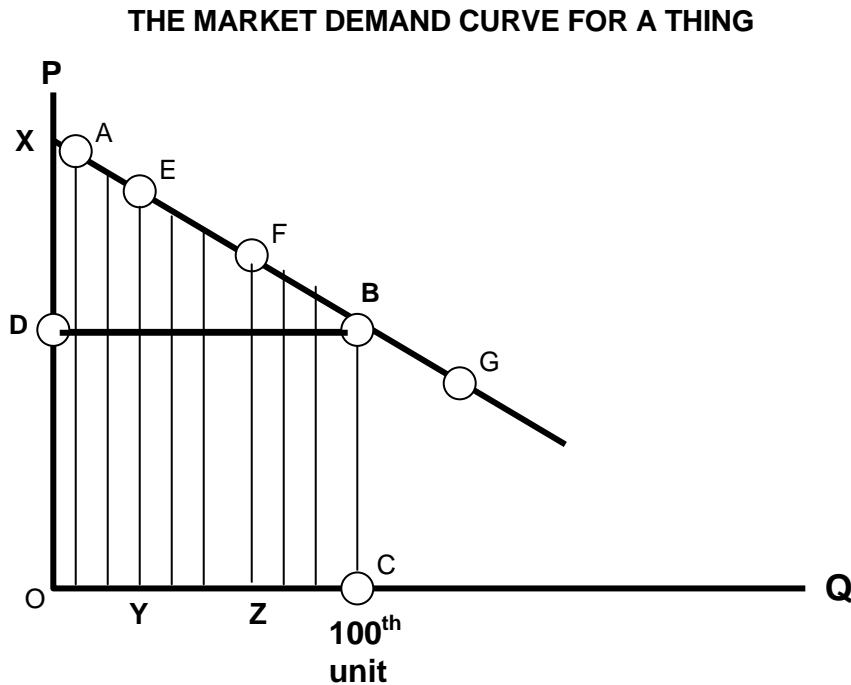
The relative position of individuals along the market demand curve may reflect differences

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<sup>3</sup> Steven E. Landsburg, *Price Theory and Applications*, 3<sup>rd</sup> ed., (1995): 258.

in taste rooted the individuals' age, gender, education, prior experience with the product and so on.

But it is reasonable to assume also that, say, individual E is willing **and able** to bid more for a unit of the thing than are B or G because E is wealthier than B or G. Even if tastes were the same for all individuals in the graph, they might offer different maximum bid prices simply because they have different incomes.



The author of your textbook – indeed virtually all textbooks in economics – would routinely assume that the total **social gross value** of, say, 100 units of the thing being produced and sold per period can be calculated as the shaded area OCBX. (If we subtract those opportunity costs from area OCBX, we would arrive at the net “social surplus” produced by this output. The latter, you will recall, is what economists seek to maximize with their “welfare analysis.”)

Now, in what sense can one really call the area OCBX the “total gross social value” of the 100 units of the thing that were produced and sold?

OCBX it is simply the sum of the different *maximum bid prices* that the 100 customers who bought a unit of the thing being traded here would have been willing to pay per unit of the thing, if push had come to shove, that is, if the seller could perfectly price discriminate and charge each customer a different price for the thing. Area OCBX is the **maximum sales revenue** that the seller of the units could have extracted from the customers under that condition of perfect price discrimination.

But can we legitimately view this “*maximum potentially extractable revenue*” as the same thing as “*social value*”?

More specifically, can we be sure at all that the last customer to deal in this market, whose maximum bid price was B, “valued” or “appreciated” a unit of the thing less – that is, derived less happiness from it – than did the customer willing to bid the higher price A?

Think about it? The person bidding B might be relatively poor, for example, and the person bidding A might be quite rich.

In equating revenue with social value, are we not in effect saying that allocating a unit of the thing to the person willing to bid A creates greater “social value” than allocating a unit to the person willing to bid only B?

To put this another way, are we not saying that if a unit of output were taken away from someone willing to bid maximally only \$10 per unit and allocated that unit to someone willing to bid \$25, that the social value begotten by that unit increases by \$15.

Finally, in yet other words, are we willing to say that the “social value” of a thing depends on the wealth of its recipient which, in turn, drives the maximum bid price (s)he is able to offer for the thing?

To make this very concrete, how would you answer this question if the “thing” in question were a dose of a pain killer or a drug-eluting stent implanted in a person or a cancer treatment, are we prepared to say it creates greater “social value” or “economic welfare” if given to a wealthy person willing to bid a high price for the treatment than it would if given to a poorer person unable to match the maximum bid price the wealthy person can bid?

But you can ask these questions in connection with any commodity whatsoever – e.g. food or books.

You will have noticed that textbooks in economics rarely if ever raise these questions when they trot out welfare economics to you. But don't you think that these are entirely reasonable questions to raise in a social science?

#### **D. CONSTANT MARGINAL UTILITY**

Our problem here would go away if the marginal utility of wealth were **constant** over all levels of wealth for each individual and, moreover, an additional \$1 of wealth triggered the same intensity of happiness (utility) for all citizens.

If that were the case, then one could legitimately argue that the different maximum bid prices different people would offer for a unit of the thing do represent equally sized differences in the satisfaction (or happiness, utility or “economic welfare”) that the different bidders derive from the thing.

Furthermore, one could then with a straight face argue that because individual E was willing to bid a much higher maximum bid price for a unit of the thing than was, say, individual F, greater human happiness or economic welfare or social value is created by the unit going to E than is created if the unit that goes to F.

Finally, one could then pretend that the shaded area in the graph above truly does represent a meaningful measure of the “total economic welfare” created by 100 units of the thing per period, prior to the deduction of production costs.

Economic welfare analysis then would make perfect sense, as would the benefit-cost analyses based on it.

Alas, the assumption of a constant marginal utility of wealth is “unrealistic” for two reasons.

First, it does not conform to common sense, as Bentham noted.

Second, the very economists who implicitly (rarely explicitly) posit **constant marginal utility of wealth** for their normative economic welfare analyses routinely posit **diminishing marginal utility of wealth** when they explain why people buy insurance. Watch your professors do it!

## D. CONCLUSION

It should be clear to you now that modern economic welfare analysis, based as it is on willingness to pay criteria, can easily end up favoring wealthier people who can bid higher money prices for a thing in question than can poorer people. In this sense, then, bastardizing Benthamite utilitarianism, as economists have done, is anything but objective science.

Welfare economists may object vehemently to this accusation. They will argue that they always assume, explicitly or implicitly, that the distribution of wealth in society that begets the bid prices used in welfare analysis is ethically acceptable or, if it is not ethically acceptable initially, that wealth will be distributed so as to make its distribution just, before the proposed policy is implemented.<sup>4</sup>

To be sure, in theory that argument does get welfare economists off the hook. In practice, however, it does not, for the following reason. To redistribute wealth, taxes must be raised and transfer payments must be made. Unless those taxes are lump-sum head taxes (\$X per person), which tend to be politically infeasible, those taxes tend to be imposed on economic activity (sales or income from work). In that form, they invariably beget inefficiencies (the dreaded deadweight losses) which economists abhor. Some economists argue that roughly 30 cents or more of every dollar taxes raised goes up in smoke through this deadweight loss.

Thus, in practice, we usually find some economists testify before legislators in the morning that wealth should be distributed to make the dicta of welfare economics ethically acceptable. At the same time, other economists in the afternoon will testify before the same legislators that such wealth distributions beget inefficiencies – the little deadweight loss triangles we had studied – and these should be avoided.

Modern applied welfare economics may look like objective science, because it typically is cloaked in mathematical symbols or graphs. At its core, however, economic welfare analysis is but one particular **distributive ethic** --- it is a **moral doctrine**. You may or may not buy it, and whether or not you do may possibly depend on – you guessed it – your wealth and ability to offer high bid prices for things.

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<sup>4</sup> Economists make this argument with the *Second Optimality Theorem* of neoclassical economics, which holds that if all markets are perfectly competitive, every thing people exchange is traded in the market and properly priced, and there are no economies of scale in producing these things, then any desired distribution of outputs among members of society can be achieved by private markets simply by redistributing income among members of society to achieve that goal, because there is then a unique, one-to-one relationship between the initial income distribution among members of society and the ultimate distribution of output among members of society (see Kenneth Arrow, "Uncertainty and the Welfare Economics of Medical Care," *American Economic Review* 53 (1963): 941-73.