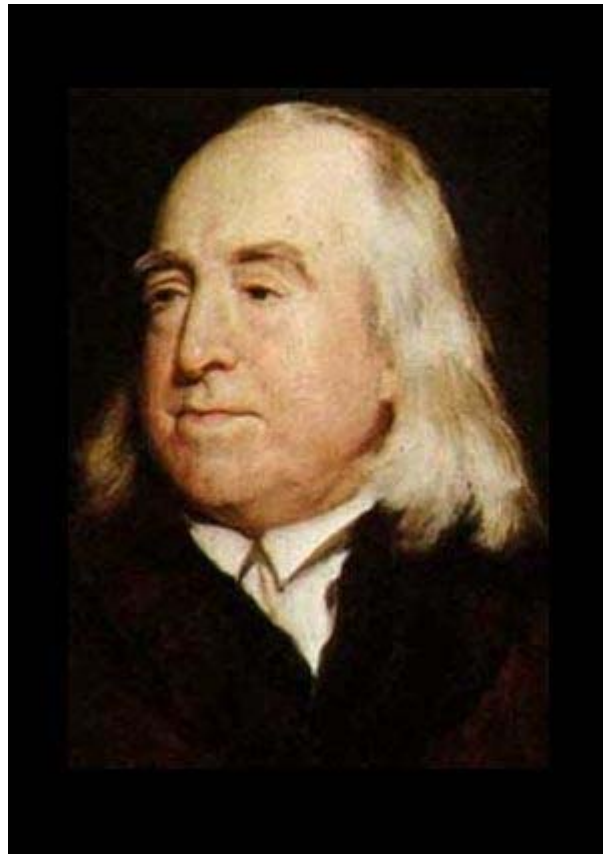


Utilitarianism and Classical Economics

- Utilitarian ethical theory has sources in Greek and Roman philosophy and in the work of Hobbes and Locke
- Scottish Philosophy—especially Francis Hutcheson
- “The greatest good for the greatest number”
- Man’s worldly happiness the only good test of social institutions

Jeremy Bentham

1748-1832



Jeremy Bentham

- Bentham the real founder of utilitarianism
- Biography
 - Read adult literature by age 3
 - Good knowledge of Greek and Latin by 6 and went to Oxford to study law at 12
 - Decided the whole basis of the law required reform
 - Law should be based on a rational and empirical appraisal of effect on human happiness (Methods of Bacon and Newton)
 - Rejection of the basis in Custom of the Common Law

Bentham's Utilitarianism

- Principle of Utility to play the central role
- “Nature has placed mankind under the governance of two sovereign masters, *pain* and *pleasure*. It is for them alone to point out what we ought to do, as well as determine what we shall do”
- Psychological hedonism—people seek pleasure and avoid pain
- Ethical utilitarianism—happiness is the only morally worthy end

Bentham's Utilitarianism

- Psychological hedonism
 - Self interest
 - Theory of individual motivation
- Ethical Utilitarianism
 - Criterion of social welfare
 - The happiness of *all*
 - Every individual counts equally
 - An action conforms to the principle of utility “when the tendency it has to augment the happiness of the community is greater than any it has to diminish it”

Bentham's Utilitarianism

- Problem of measurement of utility
- Problem of interpersonal comparisons
- Bentham's "felicific calculus": a conceptual adding up of pleasures and pains taking into account:
 - Intensity, Duration, Certainty, Propinquity (nearness in time), Fecundity, Purity, and Extent (number of people affected)
- Not an actual adding up but a guide to thinking about policy

Utilitarianism and Classical Economics

- James Mill, David Ricardo and J. S. Mill
- The “Philosophical Radicals”
- Impetus to political reform: frequent elections and a broader franchise to ensure government in the public interest
- J. S. Mill – justification of freedom of thought and expression not on grounds of natural rights but because they have important uses
- J. S. Mill’s later economics—a “modified utilitarianism” due to mixture of romantic elements

Jules Dupuit

1804-1866



Willingness-to-pay and utility

- Dupuit argued that utility (or, happiness) can be measured by willingness to pay.
 - Marginal utility of money implicitly assumed to be constant.
- Dupuit derived the downward-sloping demand curve from willingness to pay

Willingness-to-pay and Demand

- The height of Dupuit's demand curve equals marginal utility
 - So, his demand curve is the marginal utility curve
 - Leon Walras criticized Dupuit later for not clarifying the difference between the demand curve and the marginal utility curve
 - Dupuit implicitly assumed the existence of a product with constant marginal utility

Willingness-to-pay and Demand

- The area under Dupuit's demand curve is a measure of total utility.
- In this way the link between marginal utility (height) and total utility (area) was clarified

Consumer Surplus

- Dupuit defined consumer surplus as the excess of the total utility from a purchase over the consumer's payment for the purchase
- Dupuit showed that increases in price reduce the consumer surplus

Deadweight Loss

- Dupuit defined the deadweight loss of an outcome as the extent to which total utility in the outcome is less than the maximum attainable total utility
- The deadweight loss of a tax was graphically described

Tax Policy

- Dupuit showed that, to reach a tax target, it is better to have low taxes on many goods rather than high taxes on a few goods.
 - This is because the deadweight loss of a tax increases very rapidly as the size of the tax increases.
- Dupuit explained the logic underlying what today is called the “Laffer Curve”

Price Discrimination Boosts Welfare

- For a natural monopoly, price discrimination can reduce deadweight losses
 - Dupuit was an engineer, working for the government and building public works, such as the water supply, roads, and bridges
 - Naturally, he wondered what price should be charged for the public services and how the benefit to the public could be measured

Cost-Benefit Analysis

- Dupuit pioneered cost-benefit approach to the optimum provision of public goods
- He used no formal optimization; his results were usually established through numerical examples
- Dupuit's implicit assumption of constant marginal utility of money obscures the trade-offs consumers deal with in making choices.