Pigovian Welfare Economics

Pigovian lays down two conditions for maximizations of welfare:

(i) Given the taste and income distribution, an increase in national income represents an increase in welfare,

(ii) For welfare maximisation, the distribution of national income is equally important.

If national income remains constant, transfer of income from rich to the poor would improve welfare. With income subject to diminishing marginal utility, transfers of income from the rich to the poor will increase social welfare by satisfying the more intense wants of the poor. Thus it is economic equality that maximises welfare.

Prof. Pigou had a dual criterion for detecting the increase in social welfare. First, he measured the economic welfare of the society in money value and thus, given the supply of resources, an increase in national dividend meant an increase in social welfare.

Second, Pigou favoured an income equalisation policy and therefore, reorganization of the economy which increases the share of the poor without offsetting adversely "productive effort enterprise and development of capital equipment was to be taken as a gain in social welfare."

Pigou has made a distinction between private and social costs. The private marginal cost of a commodity is the cost of producing an additional unit. The social marginal cost is the expense or damage to society as a consequence of producing that commodity. Private marginal benefit can be measured by the selling price of the commodity.

Social marginal benefit refers to the total benefit that society gets from the production of an additional unit. By making a distinction between social and private valuations of economic activity, he paved the way for the analysis of external effects or externalities in social welfare economics.