Pareto Optimality

Introduction to Pareto Optimality:

The welfare of a society depends, in the broadest sense, upon the satisfaction levels of all its consumers. But almost every change in the economic state of the society will have favourable effects on some members and unfavorable effects on others.

Evaluation of such a social change is impossible unless the economist is ready to go into interpersonal comparison of utility under some value judgement, which he may not be willing to do. Rather, he will be willing to evaluate such changes where at least one person has been better off and no one worse off.

The Italian economist Vilfredo Pareto (1848-1923) said that if a change in the economic state makes at least one individual better off without making anyone worse off, then the change is for the betterment of social welfare, i.e., the change is desirable. In that case, we say that the initial state was Pareto-non-optimal.

On the other hand, if a change makes no one better off and at least one worse off, implying that the change will make the society worse off, then, from the point of view of welfare, the initial economic state is Pareto-optimal.

Therefore, the Pareto optimality criterion can be stated in this way:
A situation in which it is impossible to make any one better off without making someone worse off, is said to be Pareto optimal or Pareto-efficient.

Obviously, the concept of Pareto optimality avoids interpersonal comparison of utility. Since most government policies involve changes in the economic state, which benefit some people and bring discomforts to others, it is obvious that the concept of Pareto optimality is of limited applicability in the real world situations.