3
The Greatest Economic Theorist of Them All

Described in the fifth edition of *Chambers Biographical Dictionary* as “a Leicestershire simpleton”, Ned Ludd is remembered for his clarity of thought and decisiveness of action.

No one is quite sure when; but, sometime between 1779 and 1782, he destroyed a number of stocking-frames. His unswerving dedication to preserving the balance between skilled craftsmen and machines established his reputation within the ranks of professional “playing-field levellers”. Inspired by his example, the Luddites (as they became known) carried out similar attacks on mills in Nottingham, Yorkshire, and Lancashire. For a record seven consecutive seasons (between 1811 and 1818), they were undisputed Northern Counties’ champions.

Their major theoretical breakthrough, however, was in the field of welfare economics.

Economic Efficiency and Welfare

The textbook criterion of economic efficiency is fairly well established:

Any change of economic policy or institutions capable of making some people better off without making anyone worse off is a change that improves economic efficiency.

[Scitovsky (1952) p.55]

It has become standard textbook material that an “efficiency frontier” (or “Pareto optimum”)\(^1\) is reached where there is no further possibility

of any change which satisfies the criterion of being “capable of making some people better off without making anyone worse off”:

Allocative efficiency (sometimes called “Pareto efficiency,” or “efficiency” for short) occurs ... when no one can be made better off without making someone else worse off.

[Samuelson and Nordhaus (1995) p.264]

It is quite sufficient ... to show that even if all those who suffer as a result are fully compensated for their loss, the rest of the community will still be better off than before.

[Kaldor (1939) p.550]

Free-market economics depends for its very justification on the theorem that perfectly competitive equilibrium guarantees “Pareto efficiency”:

One brief and easily understood theorem ... provides the backbone of modern welfare economics. ... Every competitive equilibrium is a Pareto-optimum; and every Pareto-optimum is a competitive equilibrium.

[Dorfman, Samuelson, and Solow (1958) pp.409, 410]

It may, however, be worth taking a second look at the textbook argument:

Any change of economic policy or institutions capable of making some people better off without making anyone worse off is a change that improves economic efficiency.

[Scitovsky (1952) p.55]

By that criterion, a change that takes the last £1,000 from a community of paupers and gives £2,000 to a multi-millionaire “improves economic efficiency”. It is capable of making everyone better off, because the millionaire can “over-compensate” the paupers. If he were to give them, say, £1,500 he would still be better off by £500; and so would the community of paupers. To a “Leicestershire simpleton”, unencumbered with the paraphernalia of “Paretian optima” and “efficiency frontiers”, however, the flaw in the “compensation” principle is glaringly obvious. There is a big difference between compensation that hypothetically can be paid and compensation that actually is paid. If the compensation is merely hypothetical, the increase in welfare is also hypothetical. The actual result is a community of paupers left in total destitution and a multi-millionaire who may not even notice the difference.