

# The origins of the New Welfare Economics

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## **I. Introduction**

It is well known that the New Welfare economics emerged at the end of the 1930s, as a way forward from the “old” welfare economics of Alfred Marshall and A. C. Pigou, with its assumption that different individuals’ utilities could be compared, and the

sterility of a welfare economics based on no more than the Pareto criterion. But *how* did the new welfare economics emerge and come to dominate the way economists thought about the problem of welfare? Put differently, what were the intellectual resources on which the main proponents of the new welfare economics drew and how did those resources shape the way they created shaped the new field? The New Welfare Economics covers a broad range of work: Boulding (Boulding, 1952, pp. 1-2) defined it as covering the work of Abba Lerner, John Hicks, Nicholas Kaldor, Harold Hotelling, Melvin Reder and Paul Samuelson, its defining characteristic, aside from its newness, being that it did not stem from Pigou. He picked out three features:

1. it tries to establish standards of judgment by which policies “can be judged as ‘economically’ desirable;”
2. it searches for an economic “optimum” at which riches are maximized;
3. it seeks to develop “propositions which are ‘scientifically’ free of ethical judgments,” but which can be used to narrow the range of policies between which a choice has to be made on ethical grounds.

Despite this identification of the New Welfare Economics as being “like a movement or a school of economic thought”, it exhibited considerable variety. Commenting on Boulding’s survey, Samuelson (Samuelson, 1952, p. 37, emphasis added) noted that the New Welfare economics could have “two *entirely* different meanings.” One was the claim that welfare economics could be “solidly based on objective economic criteria;” the other was a systematic way of introducing ethical

criteria from outside economics. Baujard Baujard, 2011, drawing on the contrast between on the one hand Hicks and Kaldor, and on the other Bergson and Samuelson, has called these the British and American approaches to the New Welfare Economics. These labels are problematic. For example, Reder's *Studies in the Theory of Welfare Economics* Reder, 1947 is closer to Hicks than to Samuelson, despite being American. Moreover, views evolved, Samuelson going so far as to claim, in 1952, that he knew no one who still defended the first position. However, despite this, I suggest that if we are to understand the origins of the New Welfare Economics, it is important to be aware of transatlantic differences.

## **2. John Hicks**

In a lecture delivered in May 1939 in Stockholm, Hicks outlined "the new welfare economics" (Hicks, 1939a, p. 698). All economists agreed that economists should explain economic phenomena and, so far as this was possible, should make predictions about the future. There was, however disagreement over whether the economist should lay down principles about what was good for social welfare. One group, including Pigou, believed that economists could and should do this but another group, which he labelled "positivists" on account of their belief in a positive economics, valid for everyone, denied that this was something the economist should do. According to this group, "the economics of welfare, the economics of economic policy, is too unscientific in character to be part of economic *science*" (Hicks, 1939a, p.

696). Hicks confessed to having taken the second view but the problem with it was that it meant that “economic positivism” became “an excuse for the shirking of live issues, very conducive to the euthanasia of our science.”

Fortunately, Hicks continued, economists including Roy Harrod, Kaldor and Hotelling had recently found a way round the problem—a way to say something useful about policy without violating the canons of positivism. Formulating the economic problem in a Paretian manner as the satisfaction of wants subject to the constraints imposed by limited production and the wants of other people, Hicks argued that the economist was “obliged” to consider how far economic activities were effective in achieving the ends for which they are designed: to explain how efficiently the economic system adjusts means to ends (Hicks, 1939a, p. 699). The way to do this without making unjustified inter-personal comparisons of utility was to focus on eliminating situations where someone could be made better off without making anyone else worse off, if necessary achieving the latter by compensating anyone who lost out from a change. He thus concluded that “A ‘permitted reorganisation’ must thus ... be taken to mean a reorganisation which will allow of compensation being paid, and which will yet show a net advantage” (Hicks, 1939a, p. 706). Hicks concluded that this procedure allowed Welfare economics (the “Utilitarian Calculus”) to be considered “an integral part of economic theory, capable of the same logical precision ... as its twin brother, Positive Economics, the ‘Economical Calculus’” (Hicks, 1939a, p. 712).

It is useful to note that the *first* stage in Hicks's argument was to adopt a "welfarist" approach, presuming that welfare was related, in some way that he had to work out, to the utilities achieved by individuals. In making this judgment he did not present himself as making an ethical judgment but as facing a consequence of a particular way of conceiving the economic system. This was, of course, the conception of economic activity recently articulated by his senior colleague at the London School of Economics, Lionel Robbins, in *An Essay on the Nature and Significance of Economic Science* (1932). In that book Robbins had defined economics as the science that studied the allocation of scarce resources between competing ends. Hicks was therefore claiming that welfare economics could be fitted into Robbins's conception of scientific economics.

The extent to which Robbins drew significantly on continental, as opposed to English, sources can be debated, but two such sources are cited at significant points in the argument. He cited Max Weber at the outset as his source for the idea that the unity of the problems solved by a science is discovered only when the interconnection between its explanatory principles has been discovered (Robbins, 1932, p. 2, citing Weber, 1904, p. 166). This unification of the problems and explanatory principles was central to his argument. Later on he also cited Weber on the argument that propositions about "ought" are different in kind from propositions involving "is", making the strong claim that "On all of this it seems to me that the elucidations of Max Weber are quite definitive. Indeed, I confess that I

am quite unable to understand how it can be conceived to be possible to call this part of Max Weber's methodology in question" (Robbins, 1932, p. 133, citing Weber ({Weber, 1917, #32451})).<sup>1</sup>

With two exceptions, Hicks confined his citations to recent works by Anglo-American economists; Robbins was mentioned without considering it necessary even to name the book to which he was referring. The two exceptions, possibly connected to the fact that his article was first delivered as a lecture in Sweden, were to a technical point by Erik Lindahl (of whose work he was making use in *Value and Capital* (1939b) and to Gunnar Myrdal's *Das Politisches Element in der nationaloekonomischen Doktrinbildung* (Myrdal, 1932, translated as Myrdal, 1953). This is significant because, though it was a brief reference and it is not clear whether he numbered Myrdal among the positivists or cited him as having explained their views, it was his only source for the philosophical position he was taking.

Like Robbins, Myrdal presents his work as supported by the ideas of Weber and his disciples, but his emphasis is very different. In contrast with Robbins optimistic view, according to which avoiding value judgments is a fairly straightforward task that can be met adopting his approach to economic theory, Myrdal emphasises the pervasiveness of value judgments. The political element in economic theory cannot be avoided simply through confining one's work to rational arguments based on first principles. The book is a demonstration of how, despite their protestations of

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<sup>1</sup> Robbins also cited Weber in support of his criticisms of "Historismus" and Institutionalism; and on the impossibility of measuring marginal utility.

being scientific, economists had, throughout the history of the subject, often introduced normative principles in the shape of general “concepts.”

By operating with definitions which purport to be universally valid, people have often succeeded in making an implied political principle appear logically ‘correct.’ Psychologically, it is the other way round. The emotive force which is rationalized in the implied principle makes the normative element that has been disguised in the definition appear to be absolute and ‘correct.’ The perpetual game of hide-and-seek in economics consists in concealing the norm in the concept. Myrdal, 1953, p. 192.

Robbins’s assumption that the whole of economics can be deduced from the assumption of scarcity would seem to be a clear example of what Myrdal’s first sentence is warning against. Myrdal advised that it was important to eradicate from economics “all valuations tacitly implied by the basic concepts,” because, “being concealed, they are more insidious and more elusive, and hence more likely to breed confusion.”

Myrdal also challenged the common assumption that there was a harmony of interests. This was something for which factual evidence needed to be found. Whereas economists tended to gloss over conflicts of interest, it was important that they analysed them. Even Marx fell prey to the idea that there were common interests. Neither should it be assumed that people were motivated solely by economic interests—something Knight repeatedly emphasised—for people have

ideals that have greater emotive force. It was problematic trying to infer attitudes from observed behaviour or to change attitudes; even where attitudes were based on incorrect information, changing them was a matter of social psychology not of logic.

His conclusion was very un-Robbinsian. “Only if economists are modest in their claims and renounce *all* pretensions to postulate universal laws and norms can they promote effectively their practical objectives, viz., to keep political arguments rational, that is to say, to base them on as complete and as correct a knowledge of the facts as possible” (Myrdal, 1953, p. 206, emphasis added). Even the assumption that arguments should be rational depended on “the tacit assumption that rational argument is desirable.” That might not be controversial, but it was nonetheless a value judgment, comparable with the ones Weber associated with the scientist in “Science as a vocation.”

### **3. Abram Bergson and Paul Samuelson**

Bergson and Samuelson came to the idea of a social welfare function whilst attending courses as graduate students at Harvard in 1935-7 (see Backhouse, 2017). They both wrote articles on consumer theory in which they noted, Bergson implicitly and Samuelson explicitly, that there was a gap between that field and welfare economics. Bergson wrote that utilities, as calculated by Ragnar Frisch, whose work he was criticising, could “in no sense be considered measurements of real money utility” (Burk (Bergson), 1936, p. 42, n. 1). If it did not measure real



money utility then a fortiori it could not have welfare implications. Samuelson went further, writing at the end of his first paper:

any connection between utility as discussed here and any welfare concept is disavowed. The idea that the results of such a statistical investigation could have any influence upon ethical judgments of policy is one which deserves the impatience of modern economists. (Samuelson, 1937, p. 161)

He made exactly the same point in his next publication:

nothing said here in the field of consumer's behaviour affects in any way or touches upon at any point the problem of welfare economics, except in the sense of revealing the confusion in the traditional theory of these distinct subjects. (Samuelson, 1938, p. 71)

The most significant remark here, because of the way they were to develop their own ideas on welfare, as in the first quotation, where he describes welfare economics as "ethical judgments of policy."

Their starting point was Pareto. At some point in 1937, during the second year of Samuelson's coursework, Bergson kept asking Samuelson, "What can Pareto mean by this 1898 use of the French singular when he speaks of 'the social optimum'?" (Samuelson, 1981, p. 224). Their conclusion was that Pareto's writings were ambiguous and that he meant different things. Samuelson explained this to Suzumura (Suzumura, 2005, p. 334) in the following way.

I had to read Pareto in the Italian original, and my command of Italian was very poor. Nevertheless, I had a feeling when I read the 1913 article—I say this with diffidence—that he may momentarily have had the notion of an imposed-from-outside social welfare function ... But I thought I detected in it also a positivistic real political function of certain elites in any society. Each one of these elites has different power, like the powers of father and mother, oldest son, younger sons in a family. If you try to get a demand function for the family, you must combine these different influences. Generally speaking, when you do that, you don't get an integrable function. To me, that was what Pareto was talking about in the 1913 article.

Samuelson makes two points here. The first is that he thought Pareto glimpsed the idea of “a positivistic real political function of certain elites in society”, an idea he no doubt expressed diffidently as he could have been reading Arrow's social welfare function into his memory of Pareto. The second, is the idea that he and Bergson developed: the notion of “an imposed-from-outside” function that represented a particular set of ethical values. Welfare was a normative judgment conceptually completely different from propositions about behaviour.

Bergson (Bergson, 1938) was the first to publish on the subject. He wrote down a social welfare function that depended on:

- the quantities of goods consumed by each individual in the society;

- the amount of labour each individual devoted to producing each good;
- the amounts of non-labour factors of production used in producing each good;
- any other factors that might affect welfare.

As it stood, such a social welfare function said almost nothing, for it had no content beyond saying that welfare depended on all types of economic activity taking place and a unspecified other factors. It could, however, be used as a framework with which to understanding the arguments of other economics, such as Pigou's concept of "Economic welfare."

One of the main propositions in Bergson's article, which was echoes the conclusions drawn by Samuelson in his two articles on consumer theory, was that analyzing welfare in terms of utility was not an alternative to making value judgements: it was a way in which value judgements were brought in. Bergson did not consider it a useful approach:

[It] does not provide an alternative to the introduction of value judgments.

First of all, the comparison of the utilities of different individuals must involve an evaluation of the relative economic positions of these individuals. No extension of the methods of measuring utilities will dispense with the necessity for the introduction of value propositions to give these utilities a common dimension. Secondly, the evaluation of the different commodities cannot be avoided, even tho this evaluation may

consist only in a decision to accept the evaluations of the individual members of the community. (Bergson, 1938, p. 327)

Like Hicks, he was rejecting utilitarianism, but he was reaching that conclusion by different reasoning.

Though Samuelson discussed welfare in the context of international trade, he did not publish on welfare economics until his friend George Stigler attacked the “new welfare economists” for claiming that “many policies can be shown ... to be good or bad without entering a dangerous quagmire of value judgments” (Stigler, 1943, p. 355). They failed to recognise that societies were concerned with more than maximizing national income.<sup>2</sup> Policy changes would lead to changes in individuals’ preferences, making it impossible to use them as the basis for welfare analysis. What societies required, Stigler contended, was consensus on the ends that society is to seek.

Samuelson agreed with much of what Stigler was saying—economic welfare was not necessarily the main goal in society and tastes would change—but he believed that Stigler had got the new welfare economics completely wrong. The new welfare economics was not intended to displace the old but to derive necessary conditions for social welfare, basing them on the very mild assumptions that it is better to have more than to have less, and that “individual tastes are to ‘count’ in the sense that it is ‘better’ if all individuals are ‘better’ off” (Samuelson, 1943, *ibid.*, p. 605). He was not

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<sup>2</sup> Note that this was published during a crucial year in the Second World War.

denying that ethical judgments are needed for welfare conclusions but he was arguing that the ones made in the new welfare economics were very weak and generally acceptable.

Possibly prompted by his friend's clear misunderstanding of the new welfare economics, Samuelson added a chapter on the subject in *Foundations of Economic Analysis*, the book he was then revising for publication. In that he took up Bergson's idea of a social welfare function but, instead of using it to tackle debates over welfare in the 1930s, he focused on its use to represent ethical judgments.

Without inquiring into its origins, we take as a starting point for our discussion a function of all the economic magnitudes of a system which is supposed to characterize some ethical belief—that of a benevolent despot, or a complete egoist, or “all men of good will,” a misanthrope, the state, race, or group mind, God, etc. Any possible opinion is admissible, including my own, although it is best in the first instance, in view of human frailty where one's own beliefs are involved, to omit the latter.

(Samuelson, 1947, p. 221)

All he assumed about such ethical beliefs was that they provided an ordering of possible states of the world and that they were transitive (that if A was better than B, and B better than C, then A was better than C).

Samuelson then introduced a series of value judgements, each of which narrowed down the range of possible social welfare functions, the crucial one being that

individuals's preferences "count". This was a politically charged ethical judgment, and Samuelson was prepared to modify it so as to rule out Veblenian conspicuous consumption, envy and related phenomena. But if it were accepted, it meant that the social welfare function could be written as  $W = W(U_1(\cdot), U_2(\cdot), \dots, U_n(\cdot))$ , from which he could derive the now-familiar Pareto efficiency conditions relating to production and exchange. He then explained that further assumptions that might appear to be technical, mathematical assumptions—that the social welfare function be nearly symmetric with respect to the consumption of all individuals (that everyone counts for approximately the same) and that welfare was the sum of individuals' cardinally measurable utilities—involved further value judgments. Samuelson thus reached the same conclusion as Hicks and Kaldor, but rather than imply that he was avoiding making ethical judgments, he made ethics central to his argument. He reached "welfarist" conclusions but did so only at the end of his argument and only as the result of one possible ethical judgment.

Like Hicks, one of Samuelson's sources was Robbins, cited as the source for the idea that value judgments had no place in scientific analysis. However, where Hicks endorsed this, Samuelson claimed it went too far:

It is a legitimate exercise of economic analysis to examine the consequences of various value judgments, whether or not they are shared by the theorist, just as the study of comparative ethics is itself a science like any other branch of anthropology. (Samuelson, 1947, p. 220).

Contrary to Robbins and many proponents of the new welfare economics, Samuelson contended that even propositions that rely on interpersonal utility comparisons have “real content and interest for the scientific analyst” even though the economist may not wish to deduce or verify the ethical judgments on which they rest, “except on the anthropological level”.

There is no direct evidence that Bergson and Samuelson engaged directly with either Weber or Myrdal, though they could well have done. *Das Politisches Element in der nationaloekonomischen Doktrinbildung* was reviewed in the *Journal of Political Economy* (Mason, 1934) and it was discussed in *Econometrica* annual survey of economic theory (Akerman, 1936), two sources that Bergson and Samuelson will both have read. Myrdal visited Harvard in 1939 and they undoubtedly knew of his work, two of their friends translating his *Monetary Equilibrium* (1939) into English. However, even if they had not read Myrdal, they were to be exposed to Weberian ideas through a different source, Frank Knight one of Samuelson’s most important undergraduate teachers and Samuelson claimed that, when he left Chicago, he had read everything that Knight had ever written.

#### **4. Frank Knight**

When Stigler claimed that societies were concerned with more than maximising national income, he was making a point that echoed the views of one of his teachers at Chicago, Frank Knight. Starting in November 1949, he and three fellow-graduate

students had assembled and arranged for the publication of a collection of Knight's essays, titled *The Ethics of Competition* (Knight, 1997), the dominant theme in which was the relationship between ethics and economics. Samuelson was not involved in this project but, as a final-year undergraduate who was friendly with Stigler and who claimed to have been besotted with Knight, reading everything he had ever written, he will have been familiar with these essays. He loved Knight's iconoclasm and these essays represent that clearly. After he moved to Harvard, he moved away from Knight but he continued to engage with Knight, and his stress on the centrality of ethics to welfare economics was entirely consistent with the position Knight took.

A repeated theme in Knight's writings was that wants were not to be taken as given. They were in large part determined by the economic system. Thus while he found much to admire in Pigou's work, he was critical of the idea that welfare should be calculated by adding up the total of satisfied wants. Thus whilst he accepted the argument that individualism and the free market would place resources in the hands of those who valued them most, and maximise the social dividend, he denied that this constituted "a sound ethical social ideal" (Knight, 1923, p. 588; 1997, p. 40). Social ideals had to come from ethics, not from arguments about the efficiency of the economic system.

We contend not merely that such ideals are real to individuals, but that they are part of our culture and are sufficiently uniform and objective to



form a useful standard of comparison for a given country at a given time.

... In what follows we shall appear to what we submit to be the common-sense ideals of absolute ethics in modern Christendom. (Knight, 1923, p. 583; 1997, p. 36).

Like Myrdal, he attached great significance to conflicts over values and the difficulty of resolving them; social changes bring about institutional changes and involve ideas about the kind of people we want to be, for tastes and values are continually evolving (see Emmett, 2009, p. 99). Knight made no attempt “to ‘settle’ moral questions or set up standards” but merely to “bring out the standards involved in making some familiar moral judgments in regard to the economic system, and to examine them critically (Knight, 1923, pp. 583-4; 1997, pp. 36-7). Knight summarised his methodological position as being “any judgment passed upon a social order is a value judgment and presupposes a common measure and standard of values, which must be made as clear and explicit as possible if the judgment is to be intelligent. Economic efficiency is a value category and social efficiency an ethical one” ((Knight, 1923, p. 623; 1997, p. 66).

Knight thus took into account the need for physical goods and the implications of the process of competition. His conclusion was that, irrespective of whether or not it was possible to find a better form of social organisation, the competitive system had weaknesses. “There is,” he wrote, “a certain ethical repugnance attached to having the livelihood of the masses of the people made a pawn in such sport [i.e. “business

considered purely as a game”], however fascinating the sport may be to its leaders”, contrasting action motivated by rivalry with “the Pagan ethics of beauty or perfection and the Christian ideal of spirituality” (Knight, 1923, p. 624; 1997, p. 67).

Like Myrdal

Though Knight did not cite him in his writings on ethics and economics, Knight probably engaged much more deeply with Weber’s work than any other economist discussed here. He became familiar with Weber’s work before 1920 and produced a translation of Weber’s *General Economic History* (1927) into English. He praised Weber for having gone more deeply into the causes of capitalism than any other historian (Knight, 1928, p. 143). In the 1930s he was close to Talcott Parsons and Edward Shils, involved in translating key texts, including the two cited by Robbins on objectivity and value neutrality (Weber, 1904, Weber, 1917, chapter 9). Knight found Weber’s ideas useful in addressing the question of how social science could make progress. Samuelson left Chicago two years before Weberian texts were made part of the general courses in social science, but he was there when Knight and sociologist Louis Wirth, who taught social science, were fully engaged with Weber’s work (see Scaff, 2011, chapter 11). After the First World War and the collapse of progressivism, confidence in science remained, but there was no consensus on what form social science should take. In trying to define a way forward, Knight drew on two Weberian ideas: comparative economic history and his notion of theory as dealing with ideal types. The result was that although Knight was not an

institutionalist, he did not dismiss institutionalism and historicism out of hand in the way that Robbins did.

## 5. Conclusions

It is no surprise to find that Weber's ideas about value neutrality were one of the sources on which the creators of the new welfare economics drew. What is more significant is the very different routes by which Weberian ideas reached Hicks on the one hand and Bergson and Samuelson on the other. Value-neutrality, as presented in Robbins's *Essay*, was a feature of economic theory properly derived from assumptions about the world that were indisputably true. It is likely that, through his exposure to Myrdal, Hicks had encountered Weber's argument that value judgments are inescapable, even in seemingly abstract economic theory, but if he had, it left no trace on his version of the new welfare economics. In complete contrast, Samuelson had been exposed to Weberian ideas through Knight, whose position on the role of values possibly went even further from Robbins's position than Myrdal. He could not possibly have read all of Knight's work without having encountered, repeatedly and forcefully, the argument that people held conflicting values that could not easily be resolved and that such conflicts were an inescapable result of who we are. He would have picked up very clearly the idea that values have to come from outside the economic system.

Though it would be going too far to say that this explains why they formulated the idea of a social welfare function, it could certainly explain why the Hicksian formulation of the new welfare economics had no appeal for Bergson and Samuelson. Ideas learned from Knight explain the way Samuelson conceived the social welfare function. It was a way of expressing values that prevailed within society, but because values had to come from outside the economic system, they could come from anywhere. The idea that a social welfare function could represent the ethics of an egoist, a misanthrope, a benevolent despot, or God, Samuelson was expressing a position that could have been taken straight from Knight.

Both Hicks and Samuelson ended up with a welfare economics that focused on Pareto efficiency and related social welfare to individuals' own perceptions of their own welfare. They were both welfarist according to Sen's (1979) definition of the term, in that welfare was assumed to depend on individual utilities. This provides much of the justification for including Bergson and Samuelson as part of the new welfare economics. However it is important to note the contradictory ways in which they reached that conclusion. For Hicks, it was a corollary of the Robbins definition of economics and was embedded in the new welfare economics from the start. Perhaps this is one reason why he showed no sign of being responsive to Myrdal's arguments. For Samuelson, on the other hand, it came right at the end of his analysis which, in its most general form allowed for non-welfarist elements in the social welfare function. It was only when he narrowed down the social welfare function by

adding possible value judgments that he derived Pareto efficiency conditions and his conclusions became welfarist. Instead of asserting a value-free way to make welfare judgments, he was saying that a certain value judgment was implicit in any welfare economics of the Hicksian type. It could be seen as a Myrdalian “immanent critique” of welfare economics, though one inspired by Knight rather than Myrdal. Though he did not formulate any generally acceptable alternative to welfarism in *Foundations*, there was no reason in principle why he could not have introduced widely accepted value judgments that produced non-welfarist conclusions.

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